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REPORT OF THE

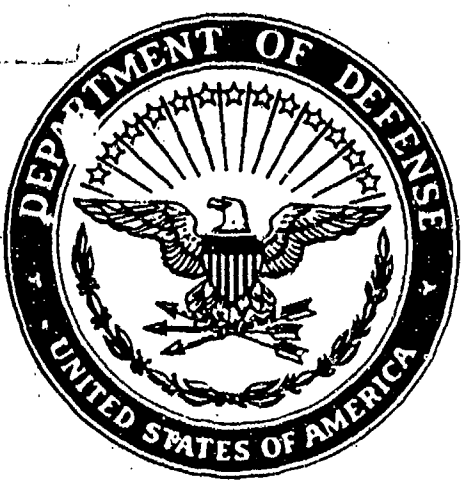
DEFENSE SCIENCE BOARD

TASK FORCE

ON

ANTITRUST ASPECTS OF DEFENSE INDUSTRY CONSOLIDATION

APRIL 1994



OFFICE OF THE UNDER SECRETARY OF DEFENSE
FOR ACQUISITION & TECHNOLOGY
WASHINGTON, D.C. 20301-3140

This report is a product of the Defense Science Board (DSB). The DSB is a Federal Advisory Committee established to provide independent advice to the Secretary of Defense. Statements, opinions, conclusions and recommendations in this report do not necessarily represent the official position of the Department of Defense.

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DEFENSE SCIENCE
BOARD

04 APR 1994

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (ACQUISITION & TECHNOLOGY)

SUBJECT: Report of the Defense Science Board (DSB) Task Force on Antitrust Aspects of Defense Industry Consolidation

I am pleased to forward the final report of the DSB Task Force on Antitrust Aspects of Defense Industry Consolidation. In the Terms of Reference, you directed the Task Force to provide advice on the Department's participation in antitrust review of defense industry mergers and joint ventures that come before the Department of Justice and the Federal Trade Commission.

After hearing presentations from experts on the defense industrial base, defense procurement, economic issues in the defense industry, and the antitrust review process, the Task Force reached a consensus view of the appropriate role of the Department in antitrust review of defense industry mergers and joint ventures by the enforcement agencies. The report concludes that competition among firms in the defense industry is significantly different from competition among firms in other sectors of the economy, but that the Antitrust Merger Guidelines are flexible enough to take into consideration the special circumstances of downsizing in the defense industry. As the report explains, the Department's knowledge of the industry and its unique perspective on the health of the industrial base can contribute to a more informed review of proposed transactions. The report provides valuable advice on how the Department can most effectively communicate with the enforcement agencies, recommending in particular that the Department cast its views in the form of traditional antitrust analyses and support them with data where possible. The report observes that the enforcement agencies will give significant weight to the Department's views on the national security implications and competitive aspects of a proposed transaction.

The report also makes several procedural recommendations. Most important, the report recommends that the Department develop an institutional capacity to coordinate inquiries regarding proposed transactions and to assemble and transmit information and views to the enforcement agencies. The Task Force concluded that these activities could be accomplished with limited staffing and that this function should be viewed as temporary. Establishing a central point of contact on antitrust issues will enhance considerably the Department's efficiency and ability to play a more constructive role in the antitrust review process.

The Task Force believes, and I agree, that the implementation of its recommendations will provide the Department with a more effective process to address antitrust issues arising from industry consolidation. I endorse the report and recommend that you forward it to the Secretary of Defense.

Paul G. Kaminski
Chairman

OFFICE OF THE SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-3140

March 24, 1994

DEFENSE SCIENCE BOARD

MEMORANDUM FOR CHAIRMAN, DEFENSE SCIENCE BOARD

SUBJECT: Report of the Defense Science Board (DSB) Task Force on Antitrust Aspects of Defense Industry Consolidation

Attached is the final report of the DSB Task Force on Antitrust Aspects of Defense Industry Consolidation. The Task Force was established by the Under Secretary of Defense (Acquisition & Technology) and the General Counsel to provide advice on how the Department of Defense can play a constructive role in antitrust review by the Department of Justice and the Federal Trade Commission of mergers and joint ventures in the defense industry. Specifically, the Terms of Reference requested advice on:

- the appropriate criteria for determining the Department's views on a given transaction;
- the data required to determine the Department's views;
- the analytical capabilities required to determine the Department's views; and
- the appropriate means for communicating with the enforcement agencies.

The Task Force heard presentations on the defense industrial base, the defense procurement process, the enforcement agencies' review process, and the economics of defense industry consolidation. We also reviewed written comments from parties expert in these issues. The Task Force then considered the questions raised by the Terms of Reference and came to a consensus view of the appropriate role of the Department in antitrust review in the defense industry. The report of the Task Force is unanimous. Its principal conclusions and recommendations are as follows:

- Competition among firms in the defense industry is significantly different from competition among firms in other sectors of the economy in various ways described in the Report, but the Antitrust Merger Guidelines are flexible enough to take into consideration the special circumstances of downsizing in the defense industry.
- The antitrust enforcement agencies are receptive to information from DOD on national security, other special concerns and facts affecting the competitive analysis of proposed transactions.
- The Department should alert the enforcement agencies to proposed mergers and joint ventures that it believes are essential to national

security and the agencies are likely to give the Department's substantiated views on this issue significant weight.

- The Department should communicate to the enforcement agencies any special concerns that do not rise to the level of national security concerns and any other views it deems relevant.

- The enforcement agencies should notify the Department of any matters that would be valuable to the Department's analysis of a transaction.

- The Department should communicate its views in the form of traditional antitrust analyses and in timely fashion; its views will be most persuasive when supported by specific facts and quantified to the extent possible.

- The Department should develop the institutional capacity to assemble and transmit information without creating a permanent or extensive bureaucracy.

- The Department need not take a position on every transaction; with respect to many proposed transactions, it may take no action or simply respond to questions from the antitrust agencies.

- The Department should assign an individual to coordinate inquiries from industry, facilitate consultations between the Department and the enforcement agencies, coordinate the Department's efforts to formulate its views and furnish information and analyses to the agencies, and coordinate and oversee any participation in court.

- DOD should continue to be available for informal consultations with and advice to representatives of firms in the defense industry about possible mergers and joint ventures.

- If DOD is asked by the parties to go beyond informal advice, it should condition its participation in the review process on a commitment by the parties to release to the Department any documents it requests that have been submitted to the enforcement agencies, and it should maintain the confidentiality of any information submitted to the maximum extent allowed by law.

The Task Force believes that the implementation of these recommendations will provide the Department with a more effective process to deal with antitrust issues arising from industry consolidation and the enforcement agencies will benefit from the Department's views. Productive communication between the Department and the enforcement agencies during the current period of industry downsizing will promote the Department's goal of maintaining competition in the defense industry without compromising the quality of the defense industrial base.

Robert Pitofsky
Chairman

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ANTITRUST ASPECTS OF
DEFENSE INDUSTRY CONSOLIDATION

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I. SUMMARY OF REPORT

The radical decline in procurement expenditures by the Department of Defense (DOD), expected to decrease by approximately 68% from 1985 to 1995, is resulting in an increase in the number of proposed mergers and joint ventures in the defense industry. The number and size of these transactions is expected to continue to grow. During the past fifteen years, DOD participation in antitrust review of mergers by the enforcement agencies (Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ)) has been uncoordinated, with the result that DOD often did not participate effectively, or at all, in the review process.

DOD has determined that it has a responsibility to participate more actively in merger and joint venture review to ensure that consolidation in the defense industry occurs in a way that protects national security as well as the financial resources entrusted to DOD. DOD's concerns include cost effectiveness, preservation of a healthy R&D capacity and surge production capacity, preservation of a base of skilled personnel, and assurance of efficiency and quality within the defense industry.

This Task Force was established by the Under Secretary of Defense (Acquisition and Technology) and the General Counsel of Department of Defense to inform DOD about antitrust analysis of mergers and joint ventures so that it can play a more constructive role in the antitrust review process of the enforcement agencies. The report also suggests some procedural reforms that will allow DOD and the enforcement agencies to collaborate in more efficient and useful ways.

By law, Congress has vested the final decision on whether to challenge defense industry mergers and joint ventures in the antitrust enforcement agencies. The Task Force does not recommend displacing the reviewing authority of the antitrust enforcement agencies directly or indirectly. Because a few government enforcement actions in the defense area have attracted much attention, there may be a misperception of the extent to which antitrust review has affected defense industry consolidation. In fact, the enforcement agencies have brought only three cases (and intervened in a fourth), while declining to review or clearing some 300 defense industry mergers in the last fifteen years. Nevertheless, DOD has an important stake in antitrust review because future transactions, given their size and potential competitive effects, may raise significant competitive and national security issues.

The report examines the many respects in which antitrust analysis of mergers and joint ventures in the defense industry should reflect and be sensitive to special factors particular to the defense industry. Although competition among firms in the defense industry is significantly different from competition in other industries, the Task Force concluded that current antitrust law and enforcement, including exercise of prosecutorial discretion, is flexible enough to take these important differences into account. It further found that the enforcement agencies are receptive to information from DOD on national security, other special

concerns, and facts affecting the competitive analysis of the proposed transactions.

Important areas where DOD can play a constructive role include the following:

° Measuring Market Power. The first step in measuring market power is defining the product and geographic market in which firms proposing to merge compete. As the primary and often the only customer, DOD is well positioned to provide information on whether two weapons systems really serve the same "mission," and to identify new products that it plans to buy that the merging firms may both be capable of developing. DOD can illuminate the question of relevant geographic market by indicating whether it is willing to consider foreign companies as prime suppliers or subcontractors on particular projects.

° Identifying Market Participants. Measurement of market share in the defense industry is unusual because historical sales may be misleading as an indicator of a firm's future competitive significance. As a sophisticated purchaser, DOD can identify factors that it believes indicate whether a particular firm or pair of firms are likely to be valuable participants in future bidding contests.

° Barriers to Entry. Mergers are unlikely to raise competitive concerns if entry into the market is sufficiently easy and would likely occur in a timely manner if prices were raised. In many defense industry mergers, entry is unlikely because of the complicated process of developing sophisticated weapons systems and because a rapidly declining defense budget does not offer attractive prospects for success. There may be circumstances where DOD can facilitate entry if costs are reasonable -- for example, by funding establishment of a new supplier, funding research and development, or making plans and blueprints available to a firm not currently in the market. Because of declining defense budgets, DOD may be far less willing or able to spend funds to replace a supplier or create a second source. The Task Force observed that the two-year time frame commonly used to assess entry probably is inappropriate in the defense industry where competition turns almost entirely on the date of the next major procurement contract.

° Competitive Effects. The basis for a finding that mergers in non-defense industries are illegal is usually that they facilitate coordinated interaction. That might be true with mergers in the defense industry involving standardized products (tents, uniforms, certain components of weapons systems), but the risk of anticompetitive effects from coordinated interaction with respect to mergers involving producers of sophisticated weapons systems is likely to be small. The systems themselves are complex and heterogeneous, and cost positions and technical capabilities of competing firms vary greatly, making it difficult to reach tacit agreements that would benefit all sellers. Also, cartels are difficult to implement when competition occurs through bids for large multi-unit, multi-year procurements.

Competition also can be lessened through unilateral effects, particularly when the merging firms account for more than 35% of the market. The greatest risk of unilateral anticompetitive effects is presented when the only two competitors in a product market propose to merge to monopoly, or the two lowest cost and therefore most efficient firms propose to merge. Mergers in those situations will need to be carefully reviewed.

° Claims of Efficiency. A broad range of efficiencies may be taken into account by the enforcement agencies in the exercise of prosecutorial discretion, and are sometimes taken into account by courts. Efficiencies will not carry much weight if they can be achieved through less anticompetitive means than mergers (for example, a temporary teaming arrangement), and must be demonstrated by clear evidence. In the situation where a merger between the only two firms in a market is proposed, a "winner-take-all" competition between the firms will almost always be preferable to a merger. A merger to monopoly could be preferable only in special circumstances and when the net benefit of efficiencies is greater than the anticompetitive effect.

° National Security Claims. Almost all claims that a merger or joint venture will contribute to national security are at bottom "efficiency claims." There will be some instances where DOD will support a merger that increases concentration substantially in order, for example, to maintain a particular research capability or the capacity to expand production promptly in case of emergency -- even though there is no decrease in unit costs. DOD should express its views to the enforcement agencies and, if necessary, in court if it believes that national security concerns are involved, and both the agencies and the courts are likely to give great weight to DOD's substantiated views.

° Failing Firm and Distressed Industry. Because of the enormous reduction in the DOD procurement budget, many mergers and joint ventures will involve firms arguing that restrictions should be eased to allow them to combine into viable competitors. Antitrust law rigorously defines a "failing firm" and generally is unwilling to take special note of conditions in a "distressed industry." DOD can offer its perspective on claims of failing firm and share information with the enforcement agencies, and may urge that economic instability and weak performance of firms in a distressed industry threatens national security interests. It can strengthen its argument by offering its views about the likelihood and consequences of business failure.

* * * * *

The Task Force report aims to facilitate constructive cooperation between DOD and the antitrust agencies in the analysis of mergers and joint ventures. As a matter of law as well as expertise and experience, the antitrust agencies bear responsibility for determining the likely effects of a defense industry merger and whether that merger should be challenged under federal antitrust laws. On the other hand, DOD has valuable views and information about the competitive effects of transactions and a unique ability and responsibility to identify proposed mergers essential to national security.

The Task Force concluded that the antitrust agencies should continue to determine the ultimate question of whether a merger of defense contractors should be challenged because it may violate the antitrust laws, or what is an essentially equivalent question, the overall competitive consequences of a defense industry merger. DOD should communicate its views concerning proposed mergers, including any analysis or information that it considers significant. All DOD views should be given careful consideration. Those views and analyses in areas where DOD has special knowledge or expertise, such as national security concerns, or those that are documented and quantified to the extent possible, should be given great weight. DOD will need only a few individuals to coordinate these matters.

On the basis of our analysis, the Task Force offers the following CONCLUSIONS AND RECOMMENDATIONS:

1. While competition among firms in the defense industry is significantly different from competition among firms in other sectors of the economy, the Merger Guidelines are flexible enough to take into consideration the special circumstances of downsizing in the defense industry, and the enforcement agencies are receptive to information from DOD on national security, other special concerns and facts affecting the competitive analysis of proposed transactions.

2. DOD should alert the enforcement agencies to proposed mergers and joint ventures that it believes are essential to national security and the agencies are likely to give DOD's substantiated views on this issue significant weight.

3. DOD should communicate to the enforcement agencies any special concerns that do not rise to the level of national security concerns that it believes might be raised by proposed mergers and joint ventures.

4. DOD should advise the enforcement agencies of any facts affecting the competitive analysis of proposed mergers and joint ventures, and of any other views it deems relevant, particularly when DOD has special knowledge on a subject. The enforcement agencies should likewise notify DOD of any matters in their knowledge that would be valuable to DOD's analysis of a transaction.

5. DOD should communicate its views to the extent feasible in the form of traditional antitrust analysis, and in the language of the Merger Guidelines, to be most effective.

6. DOD's views will be most persuasive when they are supported by specific facts and quantified to the extent possible.

In addition, the Task Force recommends the following procedural reforms:

1. In recognition of the policy significance of the information, DOD should have the institutional capacity to assemble and transmit information without creating a permanent or extensive bureaucracy.

2. It is not necessary for DOD to take a position with respect to every transaction; with respect to many proposed transactions, it may take no action or simply respond to questions from the antitrust agencies.

3. DOD should assign an individual to coordinate inquiries by members of the defense industry, facilitate consultations between DOD and the enforcement agencies about a particular proposed transaction, coordinate DOD's efforts to formulate its views and to furnish information, analyses and any views to the enforcement agencies, and to coordinate and oversee any DOD participation in court.

4. DOD should continue to be available for informal consultation with and advice to representatives of firms in the defense industry about possible mergers and joint ventures; the individual within DOD assigned the responsibility of coordinating DOD's analysis should be alerted to industry requests to DOD personnel for advice.

5. After DOD is asked by the parties to go beyond informal advice, DOD should confer and consult informally with the enforcement agencies at an early point in the review of a specific proposed transaction.

6. If DOD is asked by the parties to go beyond informal advice, it should condition its participation on a commitment by the parties to release to DOD any documents or other information submitted to the enforcement agencies, to the extent requested by DOD.

7. To the maximum extent allowed by law, DOD should maintain the confidentiality of information submitted by the participating companies. DOD should use that information for communication of views or submission of information to the antitrust agencies only for purposes of analyzing or challenging the proposed transaction.

8. To be effective, DOD should make its views known in timely fashion within the procedural timetable established by the antitrust agencies.

II. INTRODUCTION AND MISSION STATEMENT

With the end of the Cold War, the United States has pursued a policy of sharply reducing resources committed to military procurement. Secretary of Defense William J. Perry recently noted that the procurement budget has already been reduced by almost 50% in real terms from its peak in 1986, and is expected

to fall 68% in real terms from 1985 to 1995.[1] These budget reductions have led to vast overcapacity in the defense industry which can only be eliminated through downsizing and consolidation.

Much consolidation has occurred and will continue to occur through firms exiting the defense industry or converting to production in the commercial market. In many instances, however, consolidation will take place through mergers and joint ventures.

It is essential that consolidation occur in a way that protects national security, as well as the financial resources entrusted to DOD. DOD's concerns include preservation of a healthy research and development capacity, preservation of a base of skilled personnel, and assurance of efficiency, product quality and cost effectiveness within the defense establishment.

Given the size of participants in likely mergers and joint ventures and the levels of concentration already present in the defense industry, many of these transactions will be reviewed by the antitrust enforcement agencies (Federal Trade Commission and Antitrust Division of the Department of Justice), which by law are assigned the responsibility of assuring that mergers and joint ventures do not significantly lessen competition.

In the past, DOD has not participated actively in antitrust agency review of mergers and joint ventures. Individual officials of DOD or the military departments have stated their personal views regarding proposed transactions, but coordinated views have not been submitted to either the enforcement agencies or the courts. DOD has decided, given the scope of anticipated consolidations and their importance to the accomplishment of its mission, that it has a responsibility to participate more actively in merger and joint venture review. Accordingly, the Under Secretary of Defense (Acquisition and Technology) and the General Counsel of the Department of Defense established this Task Force to advise DOD on how it should discharge its responsibility with respect to merger and joint venture reviews conducted by the DOJ and the FTC. The "Terms of Reference," directing the Chairman of the Defense Science Board to establish a Task Force, include the following:

> "You are requested to form a Defense Science Board Task Force for the purpose of providing advice concerning (1) appropriate criteria for determining the Department's views on a given transaction, (2) the data required to do so, (3) the analytical capabilities required to do so, and (4) appropriate means for communicating with the enforcement agencies. Our objective in establishing the Task Force is not to generate antitrust guidelines for the defense industry or to promulgate

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[1] Perry, "Three Barriers to Major Defense Acquisition Reform," 8 Defense Issues, No. 65, p. 1 (1993). The estimate in the text is based on a reduction in funds specifically authorized for procurement and does not include spending for research and development or maintenance.

> antitrust policy for the enforcement agencies, but to obtain advice for the Department to use in formulating and expressing its views on proposed mergers."[2]

This report offers DOD an explanation of how antitrust analysis can be applied to mergers and joint ventures in the defense industry. Consistent with the Terms of Reference, its goal is neither to displace, directly or indirectly, the law enforcement authority of the two enforcement agencies in the area of antitrust nor to modify the Merger Guidelines.

The goal of the Task Force is to inform DOD about antitrust analysis so that it can play a constructive role in merger and joint venture review by the enforcement agencies. The report also proposes new or modified procedures to allow DOD and the enforcement agencies to collaborate in more efficient and useful ways.[3]

The Task Force's review is oriented toward the particular circumstances at play in the current period of industry downsizing. The recommendations in this report are intended primarily to apply to this transitional period.

The identity of members and staff of the Task Force and their backgrounds is set out in Appendix B; a description of Task Force proceedings is contained in Appendix C. This report is the culmination of the Task Force's effort to address the issues as completely as possible given the desire to come to a consensus. The members of the Task Force and its staff did not perform their duties as representatives of any organization or other group but as individuals. The contributions of the members and the staff of the Task Force to this report reflect their own independent personal views. The report represents a consensus and synthesis of these individual contributions, rather than an expression of each member's individual viewpoint as to each separate detail of the report.

III. FACTUAL BACKGROUND: TRENDS IN DEFENSE PROCUREMENT

As stated in Section II, the need for the Task Force's study of antitrust issues in the defense industry stems from the increase in mergers and acquisitions

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[2] The full text of the Terms of Reference is attached as Appendix A.

[3] Discussion in the report is primarily directed toward analysis of mergers and joint ventures between actual or potential rivals. It is conceivable that vertical mergers and joint ventures (i.e., between customers and suppliers) could be anticompetitive, but threats to competition by those sorts of transactions are less likely to lead to problems. Similarly, transactions could raise a host of other antitrust problems not involving merger and joint venture law -- for example, arrangements that amount to unjustified price fixing or exclusive dealing arrangements that unduly lessen competition. Analysis of vertical mergers and nonmerger antitrust questions are beyond the scope of this report.

flowing from industry downsizing. The defense industry has always been cyclical, following the peaks and troughs of defense spending (see Figure 1), but the breakup of the Soviet Union may make the impact of the current decline more drastic and abiding than the declines following the Korean and Vietnam Wars.

The overall defense budget is expected to decrease over 40% in real terms from 1987 to 1997.[4] More importantly from the defense industry's perspective, the procurement budget will bear the brunt of the cuts. From 1987 to 1997, force structure and operations and maintenance are only being cut 33%.[5] As noted, the procurement budget is expected to fall 68% from 1985 to 1995.[6] This decrease is especially hard on an industry that invested in plants and infrastructure in the 1980s based on expectations of continued growth.

The Bottom-Up Review, initiated by Secretary Aspin to reassess the country's defense needs in light of the end of the Cold War, charts a strategy for providing national defense in an era of declining budgets. The Bottom-Up Review concluded that the nation no longer needs the resources to fight a superpower conflict, but should maintain sufficient military power to fight two simultaneous regional conflicts. It forecasts that over the next five years, the total number of navy warships will fall from the present 450 to approximately 340; the number of attack submarines from 88 to 45-55; the number of active and reserve Air Force fighter wings from 28 to 20; and the number of Air Force warplanes from 1620 to 1200.

Manned tactical aircraft provides an example of how the budget cuts are affecting an industry segment. Actual annual DOD expenditures on manned tactical aircraft have declined from $11 billion in 1985 to $3 billion in 1993. Figure 2 charts this steady decline against the expansive spending projections of the mid and late 1980s. General Dynamics, a major player in the market, sold its tactical aircraft division to Lockheed in 1993 and Grumman announced plans to exit the market. Some industry observers believe the market will only support two or three major companies by the year 2000. Other defense industry markets may only support a single supplier. DOD already relies on single suppliers for aircraft carriers and tanks. It is shifting from dual or multiple sources to single source contracts in many other markets as well.

Excess capacity in the industry, the result of nearly a decade of escalating defense expenditures and the expectation of continued high expenditures (see Figure 2), exacerbates the effects of declining demand. Excess capacity drives competitive prices down in most industries, but in the cost-based contracts often used in defense procurement, overhead costs are assigned to ever shrinking volumes -- with the result that each unit of hardware gets more expensive.

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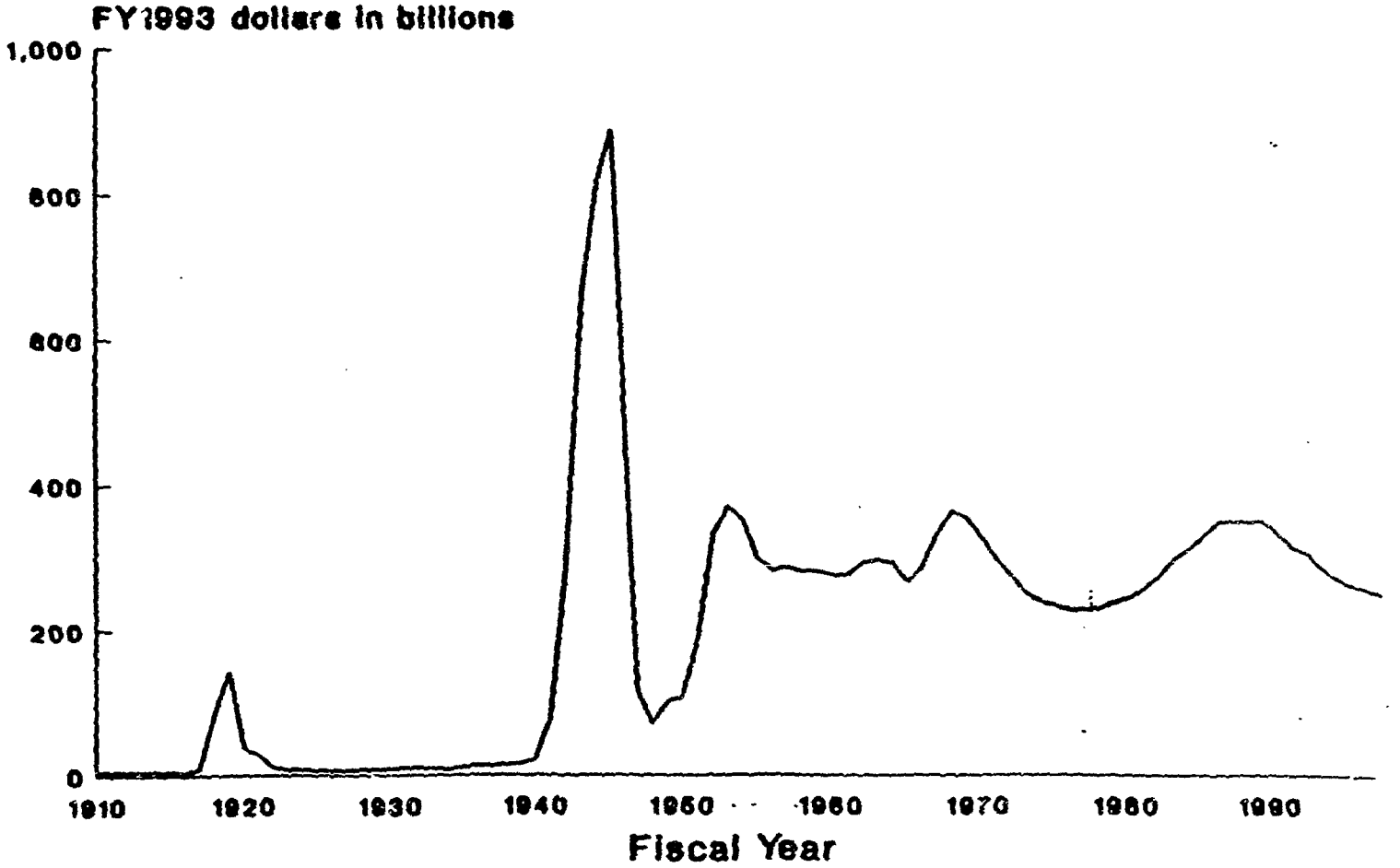
[4] Perry, Address to the Center for Naval Analyses, May 24, 1993.

[5] Ibid.

[6] Perry, note 1, supra.

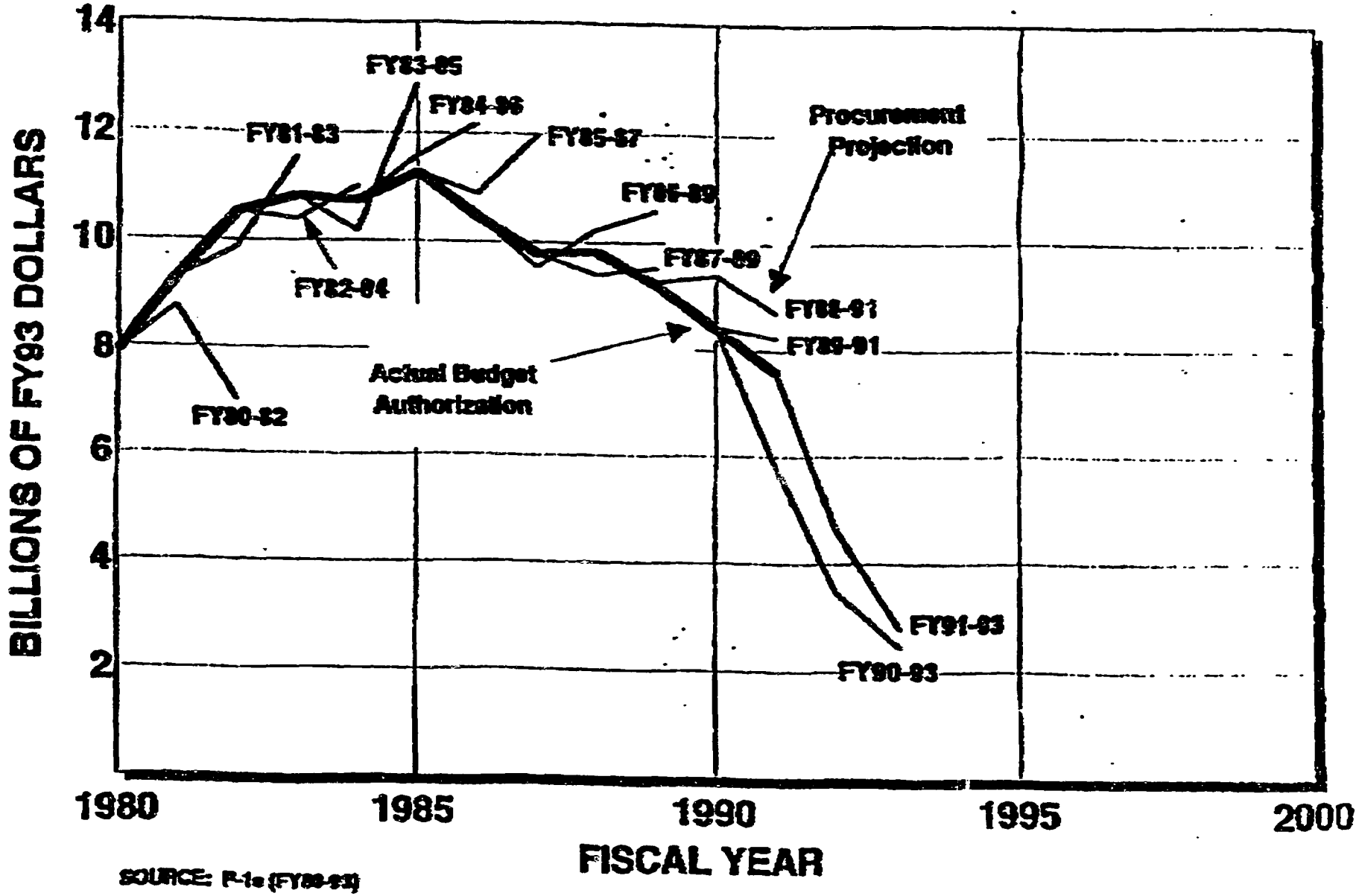
CRS Report for Congress
Defense Budget for FY 1993
Data Summary
The Library of Congress
March 18, 1992

Figure 1
National Defense Outlays
FY1910-1997



FY1993-97: Administration projection

FIGURE 2 MANNED TACTICAL AIRCRAFT PROCUREMENT PROJECTIONS VS. REALITY 1980-1991



SOURCE: R-1s (FY80-93)

Booz-Allen & Hamilton, "Consolidation in Aerospace/Defense," 1992.

Declining demand and excess capacity are driving widespread consolidation and an overall decline in the number of defense contractors. There have been over 300 defense-related mergers and acquisitions in the United States in the past 15 years. Defense Department officials have acknowledged that further consolidation within the industry is an inevitable consequence of bringing defense spending into line with the nation's needs. The Task Force's mission is to help DOD play a constructive role in the application of the antitrust laws to this consolidation.

IV. LEGAL BACKGROUND

Mergers are covered by Section 7 of the Clayton Act, which declares acquisitions illegal if their effect "may be substantially to lessen competition, or [to] tend to create a monopoly."[7]

There have been only four litigated government challenges to mergers in the defense industry in the history of the Clayton Act. Three of the matters were brought solely by the Federal Trade Commission and, in the fourth, the Federal Trade Commission joined in a private action. In all four cases, the courts concluded that there were substantial risks of adverse effects on competition and entered injunctions prohibiting the proposed acquisitions. During the same period, hundreds of defense industry mergers and joint ventures were allowed to proceed without antitrust challenge.

Over the last 20 years, whether there has been a Democratic or a Republican administration, DOD has refused to take a formal position supporting or opposing mergers (except those that led to foreign ownership of vital technologies). However, individual DOD employees have often expressed their opinions. In several instances, DOD officials took opposing positions with respect to the advisability of the same transaction.

A. Litigated Cases and DOD's Role

1. Grumman v. LTV[8]

In 1981, Grumman brought a private antitrust action to enjoin LTV from proceeding with a tender offer to acquire its stock. The FTC later filed its motion for a preliminary injunction before the same court. The district court enjoined the transaction holding that the proposed acquisition would substantially lessen competition in the markets for carrier-based aircraft, major airframe subassemblies, and nacelles (engine housing).[9]

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[7] 15 U.S.C. § 18 (1982).

[8] Grumman Corp. v. LTV Corp., 527 F. Supp 86 (E.D.N.Y.), aff'd, 665 F.2d (2d Cir. 1981).

[9] Grumman, 527 F. Supp. at 95, 98.

On appeal, the Second Circuit considered, among other issues, whether the future competitive significance of LTV was limited because the Navy had no plans to purchase any more of the carrier-based aircraft that LTV was then producing. The court upheld the injunction concluding that LTV "can reasonably be expected to provide competition in the carrier-based aircraft market."[10] In reaching its decision, the court cited (1) evidence showing an increased likelihood of future DOD purchases of carrier-based aircraft from LTV; (2) the competitive influence that LTV exerts on the market, even when its bids are unsuccessful; and (3) LTV's own internal assessment of its market significance.[11]

No official DOD opinion or position is referred to in the courts' opinions in Grumman. However, the district court cited the testimony of two former DOD officials: Admiral Elmo R. Zumwalt, Jr., a former member of the Joint Chiefs of Staff and retired Chief of Naval Operations; and George Spangenberg, former Director of the Evaluation Division of the Development of the Navy. Both former DOD officials testified that a merger between Grumman and LTV would have adverse consequences for the national defense. In balancing the equities, the court cited this testimony and determined that "the interest of the public here is greater than in the ordinary case since a lessening of competition might well affect the quality and price of weapons sold to the United States Navy."[12]

2. FTC v. PPG Industries, Inc.[13]

In 1986, the FTC sought a preliminary injunction to block PPG Industries' proposed acquisition of Swedlow, Inc. At the time of the proposed merger, PPG was the world's largest producer of glass aircraft transparencies[14] and Swedlow was the world's largest producer of acrylic aircraft transparencies. Although the parties concentrated on producing military and commercial aircraft transparencies made of different materials, the district court concluded that the companies were direct competitors in the "high technology" aircraft transparencies product market.[15] While finding that the FTC had "made a

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10 Grumman, 665 F.2d at 12.

11 Grumman, 665 F.2d at 12, 13.

12 Grumman, 527 F. Supp. at 106.

13 FTC v. PPG Indus., Inc., 628 F. Supp. 881 (D.D.C.), aff'd in part, 798 F.2d 1500 (D.C. Cir. 1986).

14 PPG also was a substantial supplier of acrylic and composite (mixed glass/acrylic) transparencies. PPG, 798 F.2d at 1502.

15 PPG, 628 F. Supp. at 884.

persuasive showing of its likelihood of success on the merits,"[16] the district court entered a hold separate order instead of a preliminary injunction.[17]

On appeal, the D.C. Circuit agreed that the firms were direct competitors, citing evidence that PPG and Swedlow had bid against each other for past projects and planned to do so again in the future.[18] The court also recognized that "[c]ompetition between [PPG and Swedlow] exists not only in bidding but at the proposal stage when airframe designers receive proposals from manufacturers offering different materials and at that stage of research and development as transparency manufacturers try to influence airframe customers about types of transparencies for future generations of aircraft."[19]

Moreover, the D.C. Circuit found that the evidentiary record supported the district court's determination that:

> . . . the FTC and Court of Appeals may almost surely be expected to find that the change in market structure following a PPG-Swedlow merger will be sufficiently inimical to competition to forbid the acquisition.[20]

The D.C. Circuit went on to overrule the lower court's decision to enter a hold separate order stating that ". . . having found that the acquisition was almost certainly illegal, the district court faced a difficult task in justifying anything less than a full stop injunction."[21] Instead, the D.C. Circuit remanded the case to the district court with instructions to enter a preliminary injunction enjoining the acquisition.

The courts' opinions in PPG make no mention of DOD's opinion or position on the proposed acquisition. However, Admiral Platt, the Navy's Competition Advocate, had agreed to testify in opposition to the transaction. Prior to the preliminary injunction hearing, DOD's General Counsel refused to permit Admiral Platt to testify in the proceeding. As a result, DOD did not formally take a position regarding the transaction.

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16 PPG, 628 F. Supp. at 885.

17 PPG, 628 F. Supp. at 887.

18 PPG, 798 F.2d at 1505.

19 PPG, 798 F.2d at 1505.

20 PPG, 798 F.2d at 1502.

21 PPG, 798 F.2d at 1506.

3. FTC v. Imo Industries Inc.[22]

In 1989, the FTC obtained an injunction blocking Imo Industries Inc.'s proposed acquisition of Optic-Electronic Corporation ("OEC"). Imo and OEC were the two most cost-competitive producers of certain image intensifier tubes used in night vision devices. The two competitors proposed to merge prior to DOD's planned final multi-year procurement of second generation 25mm tubes. The court issued an injunction concluding that the merged firm would "dominate the relevant market to such a degree that there would be a substantial likelihood of 'substantial anticompetitive effect.'"[23]

Although the Imo court issued an injunction, it recognized that the "merger could be in the interest of a strong national defense" because the consolidation of Imo and OEC might improve competition in the market for third generation tubes.[24] These alleged benefits, however, could not overcome the ". . . strong public interest in the preservation of competition."[25] As a result, the court held that it was "in the public's interest to enjoin the [Imo]/OEC merger."[26]

Following the district court's injunction, the two companies abandoned their efforts to merge and subsequently competed against each other in order to win the multi-year contract. As a result of the competition, DOD obtained a substantially lower price than it had expected to pay had the merger taken place. In fact, the savings resulting from the final competitive procurement have been estimated at approximately $23 million.[27]

Shortly after the final multi-year contract for second-generation 25mm tubes was awarded, Imo sought prior approval from the FTC to renew its offer to acquire OEC. Approval was granted and the companies were permitted to merge. As a result, the parties were able to realize whatever potential benefits the merger might have presented while DOD and ultimately the U.S. taxpayers were able to obtain significant cost savings from the competitive procurement for second generation tubes.

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[22] FTC v. Imo Industries Inc., 1992-2 Trade Cas. (CCH) § 69,943 at 68,555 (D.D.C. Nov. 22, 1989) (redacted memorandum opinion) (hereinafter "Imo").

[23] Imo, 1992-2 Trade Cas. (CCH) at 68,558.

[24] Imo, 1992-2 Trade Cas. (CCH) at 68,560.

[25] Id.

[26] Id.

[27] J. Steiger, Remarks at American Bar Association Section of Antitrust Law Spring Meeting (April 12, 1991), reprinted in 7 Trade Reg. Rep. (CCH), ¶ 50,055, at 4[illegible],697.

In Imo, DOD took no formal position with respect to the merger. The court did cite testimony of individual DOD officials in considering the FTC's claims that the proposed merger would result in a firm that could "easily raise prices."[28] Mack Farr, DOD's Technical Director for PM Night Vision, provided testimony supporting the FTC's view. Mr. Farr testified that "For Second Generation [image intensifier tubes], the government may end up paying more money. . . ."[29]

The court also considered testimony of DOD officials in evaluating the companies' claims that the proposed merger between Imo and OEC could be beneficial because it might improve competition in the market for third-generation image intensifier tubes. Colonel Martin Michlik, the DOD official responsible for acquisition and development of night vision systems, stated that "a merger between [Imo and OEC] may make a stronger third gen[eration] company for future competition. . . ."[30] John Greshem, DOD Deputy Project Manager for Night Vision and Electro-Optics, stated that although his professional opinion towards the merger was "to be neutral about what happens in the marketplace," his personal opinion was that there might be "a benefit of technical interchange" and "greater financial strength" as a result of the merger.[31]

In balancing the equities associated with the merger, the court considered the advantages and disadvantages identified by DOD's witnesses. The court concluded that although the "merger could be in the interest of a strong national defense," these alleged benefits could not overcome the ". . . strong public interest in the preservation of competition."[32] As a result, the court held that it was "in the public's interest to enjoin the [Imo]/OEC merger."[33]

4. FTC v. Alliant Techsystems Inc.[34]

In November 1992, the FTC obtained a preliminary injunction preventing Alliant Techsystems Inc. from acquiring Olin Corporation's Ordnance Division. The two contractors planned to merge prior to a DOD competitive multi-year procurement of 120mm ammunition which was designed to reduce the number of 120mm ammunition suppliers from two to one. Alliant's proposed

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[28] Imo, 1992-2 Trade Cas. (CCH) at 68,560.

[29] Imo, 1992-2 Trade Cas. (CCH) at 68,560, n.19.

[30] Imo, 1992-2 Trade Cas. (CCH) at 68,560, n.17.

[31] Imo, 1992-2 Trade Cas. (CCH) at 68,560, n.17.

[32] Imo, 1992-2 Trade Cas. (CCH) at 68,560.

[33] Imo, 1992-2 Trade Cas. (CCH) at 68,560.

[34] FTC v. Alliant Techsystems Inc., 808 F. Supp. 9 (D.D.C. 1992) (hereinafter "Alliant").

acquisition of Olin would have preempted the Army's planned final competition and would have allowed the merged firm to become the monopolist supplier of 120mm ammunition without competitive bidding. The court found that the elimination of competition between Alliant and Olin could "raise the cost of the contract for the Army between five and 23 percent, or $25 to $115 million."[35]

In addition to finding substantial cost savings associated with preserving competition, the Alliant court considered and rejected defendants' claims that enjoining the merger might endanger national security by impairing the transfer of advanced tactical ammunition technology between the two contractors. The court noted that "circumstances could arise under which national defense priorities would override any other public interest in preserving competition that might exist. . . . Those circumstances are not presented here, however."[36]

In Alliant, there were five DOD witnesses. Four were from the Army and one was from the Defense Contract Audit Agency ("DCAA"). Two of the Army witnesses testified in favor of the acquisition. One, Colonel Hartline, the program manager of the 120mm program, testified that he believed the merger offered the best opportunity for the Army to obtain the necessary 120mm rounds when needed. However, he also testified that even without the merger he believed the rounds would be available to the Army when needed. Another Army witness, Steven Conver, an Assistant Secretary of the Army, was strongly in favor of the transaction. Although he conceded he knew nothing about this particular program, he testified that he believed the Army could "protect itself" from any major price increases. The court rejected this testimony. The other two DOD witnesses testified in camera. One witness, the head of R&D for tank ammunition, testified that he believed it would be no problem for the winner of a winner-take-all competition to provide the Army with quality ammunition when needed. He also testified that past competition had led to numerous advances in quality and innovation and, even if there were only one more competition, both parties would continue to innovate in order to win that final competition. The other DOD witness, from the DCAA, testified that the Army's cost controls and auditing rights were a poor substitute for competition. The official Army position was ". . . no objection to the merger, it's not for it or against it."[37]

B. Defense Industry Mergers That Were Consummated Without an Antitrust Challenge

The small number of defense industry mergers challenged by the antitrust enforcement agencies is dwarfed by the large number of significant mergers that have been consummated without any challenge. Precise statistical data identifying the number of defense industry mergers reviewed during a

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35 Alliant, 808 F Supp. at 21.

36 Alliant, 808 F. Supp. at 23.

37 Alliant, 808 F. Supp. at 17.

pecific time period is unavailable, due in part to disagreements over the proper definition of what constitutes a "defense industry merger." While most agree that cases such as Grumman, Imo and Alliant, which involved companies that produced defense-related products for sale predominantly for military purposes, are defense industry mergers, other transactions are not as clear. For example, in PPG, the merging companies did not sell their products directly to DOD, nor were their products used exclusively for military purposes. Regardless of the definition used, those closely involved in the defense industry merger review process agree that during the past 15 years, at least 300 transactions involving suppliers of products for military use have been consummated without an antitrust challenge.

Within the past two years alone, a number of large defense industry mergers have been consummated without an antitrust challenge. These include Martin Marietta's purchase of General Electric's Aerospace Division; Lockheed's purchase of General Dynamics' Manned Tactical Aircraft Division; Hughes Aircraft's purchase of Gen ral Dynamics' Missiles Division; Loral's purchase of LTV's Missiles Division; The Carlyle Group and Northrop's purchase of LTV's Aircraft Division; The Carlyle Group's Purchase of General Dynamics' Electronics Division; Olin's acquisition of Aerojet; and Alliant Techsystems' purchase of Astra Holding Company and its subsidiaries Kilgore and Accudyne.

V. SUBSTANTIVE ISSUES

A. Introduction

Review of defense industry mergers and joint ventures by the antitrust enforcement agencies is in the public interest and continues to protect the DOD (and ultimately the United States taxpayer) against the risk that a transaction may create a firm or group of firms with enhanced market power, i.e. the power to increase prices. As a result, the Task Force does not recommend any exemption for mergers in the defense industry.

In many respects, competition among firms in the defense industry is significantly different than competition among firms in other sectors of the economy. Nevertheless, current antitrust law and enforcement, including the exercise of prosecutorial discretion by the federal antitrust enforcement agencies, is sufficiently flexible to take these important differences into account.

Mergers of firms that sell products to DOD may present a variety of different market situations. In some instances, DOD will be one of many actual or potential customers and the products will be familiar, garden variety items such as office equipment or uniforms. However, in many cases, DOD will be the sole or predominant customer and the relevant products will be expensive, technologically complex weapons systems (or related components) such as tactical aircraft, missiles, or sonar systems. The Task Force has paid special attention to the latter type of case because the radical downsizing of the defense budget is likely to have its greatest impact on future weapons procurements and on the firms that supply those products to DOD.

The 1992 Horizontal Merger Guidelines[38] outline the present antitrust enforcement policy of DOJ and the FTC for analyzing horizontal mergers and acquisitions. The Merger Guidelines provide an analytical framework to allow the FTC and DOJ to challenge those mergers that create or enhance market power or facilitate its exercise, while avoiding unnecessary interference with the large universe of mergers that are competitively beneficial or neutral.[39] Because the Merger Guidelines are intended to apply to a wide range of different industries, the standards set forth are to be applied "reasonably and flexibly to the particular facts and circumstances of each proposed merger."[40]

B. Competition Policy Concerns in Defense Industry Mergers

1. Overview

In evaluating proposed mergers, DOJ and the FTC attempt to answer a basic question -- Is the transaction likely to harm customers in any product market by leading to increased prices, lower product quality or service levels, or both? If a proposed merger either is likely to benefit customers by lowering prices and/or increasing product quality, or at least is unlikely to have any predictable negative impact on price and/or product quality, the antitrust agencies will not challenge the transaction.

Transactions that are viewed by the antitrust agencies as likely to be anticompetitive (i.e., to harm customers by leading to higher prices and/or lower product quality) are those that will "create or enhance market power" or "facilitate its exercise." Merger Guidelines, § 0.1. Even where a proposed merger is found likely to facilitate the exercise of "market power," the antitrust agencies will explore whether the merger will create efficiencies that are likely to lead to lower prices and/or improved product quality and, if so, whether the anticipated competitive benefits of the efficiencies that will be produced by the proposed merger outweigh the potential anticompetitive effects of the transaction. Merger Guidelines, §§ 0.2 & 4.[41]

There may be a misperception on the part of some members of the business community, including some participants in the defense industry, that the antitrust agencies employ a mechanical formula that assumes that a merger will

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[38] United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (April 2, 1992), 4 Trade Reg. Rep. (CCH) ¶ 13,104 (hereinafter "Merger Guidelines").

[39] Merger Guidelines, at § 0.1.

[40] Merger Guidelines, at § 0.

[41] The issue of efficiencies is discussed in detail below. The antitrust agencies focus on merger-specific efficiencies -- efficiencies that are likely to flow from the merger and that are unlikely to be achieved by other means.

"create or enhance market power" if it results in a significant increase in concentration in a market that will be highly concentrated following the merger. In fact, the Merger Guidelines state that "market share and concentration data are important but they provide only the starting point for analyzing the competitive impact of a merger." Id. §§ 0.0, 2.0.

2. Market Definition

The first step in analyzing mergers under the Merger Guidelines is defining the relevant product and geographic markets and assessing the impact of the merger on the structure of those markets. Merger Guidelines, § 0.2. The Supreme Court has defined a relevant market as the "area in which the seller operates, and to which purchasers can practicably turn for supplies."[42] Under the Merger Guidelines, demand-side considerations define the market; supply-side considerations are relevant principally to identify market participants once the market has been defined. §§ 1.0, 1.11, 2.12.

a. Relevant Product Market

The Merger Guidelines define a relevant product market from the perspective of the customers as the narrowest group of products for which a monopolist could successfully impose a "small but significant and non-transitory price increase" (typically 5%). Id. § 1.0. Where the volume of purchases that would be switched to other products is sufficiently large to render such a price increase unprofitable, the relevant product market definition is expanded until the price increase test is met.

In defense industry mergers, product market definition issues may arise in two general contexts. First, there may be an issue related to future purchases of an existing defense industry product for which there are multiple producers, such as Stinger Missiles.[43] Second, there may be a need to define product markets for the design and development of a new or future weapons system, such as the next generation manned tactical aircraft. DOD, as the primary and often the only customer, is well positioned to provide information that is important to product market definition in both of these types of situations. In many instances, DOD will have a specific "mission" that it needs to accomplish by procurement of a particular weapons system such as air-to-air missiles, rather than a broader category of products, such as tactical and strategic missiles. If there are multiple products that DOD views as providing acceptable means of accomplishing the mission, the relevant product market may include a group of substitutable products with similar end uses. Where only one product will meet the mission requirements, or where a new product is being designed

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[42] Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327 (1961).

[43] For sole-source weapons systems, such as F-18 aircraft or Patriot Missiles, there may be future DOD purchases, but no future competition. All competition ended when the original procurement decision was made.

and developed to accomplish the mission, a single product may constitute the relevant product market for merger analysis.

In practice, DOD may be able to play a valuable role in assisting the antitrust agencies in defining relevant product markets. DOJ and the FTC often begin the process of identifying the relevant product markets for a particular transaction by looking at the products that the merging firms currently produce. See Merger Guidelines, § 1.11. DOD may be able to provide facts that enable the antitrust agencies to determine, for example, whether two different sonar systems are in the same product market or are in different product markets because they have specific capabilities and cannot be used as substitutes for each other. DOD may be aware of new technological developments that may add to or subtract from the number of firms qualified to compete for future contracts. In addition, because merger analysis focuses on a potential for future anticompetitive effects, DOD's input as to whether it intends to make any future purchases of a particular product that the merging parties now produce will be highly relevant to deciding whether a historical product overlap has any future competitive significance.

One additional area that merits special attention is the assistance DOD can provide in identifying new products that it plans to procure that the merging firms may both be capable of developing. In some situations, DOD may view firms that have never bid against each other and have never produced the same defense product as likely future competitors. If there is already an ongoing design or development project for the new weapons system, the antitrust agencies may be able to spot such a product overlap on their own by examining documents supplied by the parties to the merger. However, if DOD has not yet announced its plans to develop one or more products, the antitrust agencies might not be aware of emerging product market(s) that should be examined in connection with the proposed merger.

b. Relevant Geographic Market

The Merger Guidelines set forth a similar analysis for defining the relevant geographic market. Specifically, the antitrust agencies seek to determine whether customers would switch to producers in another geographic area if there was a significant non-transitory price increase. The relevant geographic market is the area in which a hypothetical monopolist could effectively exercise market power.[44]

In the defense industry, the issue is typically whether the relevant geographic market is limited to U.S. firms or whether it also includes foreign firms. DOD often specifically limits its pool of qualified suppliers to domestic companies, even though technically capable foreign bidders may exist. DOD purchases the majority of its defense related products from U.S. suppliers in order to preserve its domestic mobilization base, promote domestic employment,

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[44] Merger Guidelines, at § 1.21.

and encourage high technology research and development by U.S. companies.[45] Further, many DOD procurements are subject to "Buy American" restrictions that may either mandate that a domestic supplier be used or grant preferential status to U.S. competitors. If the above restrictions deter DOD from switching to foreign producers in the event of a five percent price increase, the relevant geographic market will be limited to the United States.[46]

While foreign suppliers are generally precluded from competing as prime contractors for critical and/or sensitive DOD weapons systems, overseas firms may still be able to participate as subcontractors or as prime contractors for less critical DOD programs. In addition, as the number of domestic suppliers continues to shrink, DOD may become more willing to turn to foreign sources. In those situations where DOD is able and willing to switch to foreign suppliers in response to an exercise of market power by domestic suppliers, the relevant geographic market will be broader than the United States. Thus, DOD has a critical role to play in defining the relevant market.

3. Identification of Market Participants and Market Shares

The Merger Guidelines emphasize market concentration as an important factor in assessing the risk that a merger will create or facilitate an exercise of market power. This exercise has two elements: identification of market participants and determining each participant's share of the relevant market.

Participants in the relevant market include both those firms that are currently producing/selling the relevant product and those that could do so relatively quickly and easily. "Uncommitted entrants" are those firms that are capable of entering into the supply of the relevant product within one year and without incurring significant sunk costs of entry and exit.[47] Uncommitted

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[45] See, e.g., Imo, 1992-2 Trade Cas. (CCH) at 68,557, n. 12; William B. Burnett & William E. Kovacic, Reform of United States Weapons Acquisition Policy: Competition Teaming Agreements, and Dual Sourcing, 6 Yale J. on Reg. 298, n.180 (1989); see also, William E. Kovacic, Merger Policy in a Declining Defense Industry, 36 Antitrust Bull. 543, 585-586 (Fall 1991).

[46] In addition, as a practical matter, many DOD procurements are limited to U.S. suppliers because they are the only existing suppliers with the technological capability necessary to produce the relevant product.

[47] Merger Guidelines, at § 1.32. The Merger Guidelines define sunk costs as "the acquisition costs of tangible and intangible assets that cannot be recovered through the redeployment of those assets outside the relevant market. Merger Guidelines, at § 1.32. A sunk cost is significant if it "would not be recouped within one year of the commencement of the supply response, assuming a 'small but significant and nontransitory' price increase in the relevant market." Merger Guidelines, at § 1.32.

entrants are included as market participants because their ability to make quick supply responses without a major investment is likely to exert a competitive influence on the market both before and after the merger.[48]

DOD can provide valuable assistance to the antitrust agencies in identifying firms that currently produce the relevant product, or could do so without the expenditure of significant sunk costs and therefore are in the market. When this question relates to the production of a particular weapons systems (such as a particular type of air-to-air missile), the answer may be straightforward. However, DOD's judgment may be useful to determine which firms should be viewed as likely participants in the future design and development of a new weapons system. Indeed, DOD may limit the number of competitors by asking only a few firms (or teams of firms) to bid on such a design project or by awarding design contracts to two or three firms. In addition, in many instances, DOD limits the number of market participants by establishing a mobilization base of suppliers that become the only firms qualified to bid for specific contracts.

In those situations where DOD does not expressly limit the market participants, e.g., through a mobilization base or through exclusion of foreign participants, the enforcement agencies will examine the steps required to assemble the capital equipment, personnel, and research and development necessary to compete in the relevant markets. If these steps take longer than one year to accomplish or require the expenditure of significant sunk costs, there may be no "uncommitted entrants" in those markets. On the other hand, DOD may elect to expand the market by inviting other firms to participate in the event two of the current competitors merge. DOD could decide that there are no additional firms capable of competing or that the time frame for the project will not permit it to add a new participant in response to a merger. Such decisions by DOD would be important to identify the firms participating in a particular market.

Market concentration is determined by analyzing the size and number of firms in a particular market.[49] The antitrust enforcement agencies employ the Herfindahl-Hirschmann Index ("HHI") to measure market concentration.[50] The Merger Guidelines characterize markets as either unconcentrated (HHI below 1,000), moderately concentrated (HHI between 1,000 and 1,800) or highly concentrated (HHI over 1,800).

Although market concentration statistics are generally derived from historical market data, the Merger Guidelines recognize that "in some situations, market share and market concentration data may either understate or overstate the

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[48] Merger Guidelines, at § 1.0.

[49] As discussed in Section V.B.5, concentration is relevant to determining risks of anticompetitive conduct.

[50] The HHI is calculated by summing the squares of the individual market shares of each participant.

likely future competitive significance of a firm or firms in the market or the impact of a merger."[51] Indeed, due to the rapidly changing, high technology nature of many defense products, plummeting demand for most defense products, and the unique nature of the DOD procurement process, historical market data may be an unreliable predictor of future competitive conditions in many defense-related markets. For example, a company that is concluding a weapons system production run, but has refocused its research and development efforts on non-defense activities may possess a large market share, yet have little likelihood of winning future DOD awards. Similarly, looking to sales based on prior bidding competitions may well overstate the winner's competitive significance and understate the significance of firms that remain capable of supplying the product to DOD in the future.

As a result, in defense-related markets, it may be inappropriate to assign precise market shares to individual firms in order to calculate the effect of the merger on market concentration. Indeed, it may be far more important for the antitrust agencies in assessing the potential for the lessening of competition to obtain information on (1) the cost positions of the merging firms relative to each other and to the remaining competitors and (2) the technological capabilities of the merging firms and each of their competitors. DOD may be able to provide the antitrust agencies with important factual information as well as offer informed assessments relating to these issues.

One approach suggested by the Merger Guidelines is to assign equal shares to each firm that is capable of bidding for future procurements. Merger Guidelines, § 1.41, n.15. Such an approach, however, may overlook significant differences in the cost positions or technological capabilities of the competing firms.

DOD often will be in a position to provide the antitrust agencies with insights on the impact that it believes a merger would have on upcoming procurements in which the parties to the merger were expected to bid against each other. The following two "cases" illustrate the important role that DOD can play.

Case 1. Two of the four firms that DOD believes are capable of bidding on an upcoming procurement propose to merge. DOD views one of the parties to the proposed merger as both high cost relative to the other three firms and as significantly less technically capable than the other three firms. In this situation, DOD's evaluation may assist DOJ or the FTC in concluding that there is little risk of competitive harm because the merger of the fourth ranking firm with one of the top three competitors is unlikely to affect adversely the outcome of the bidding process. It is possible that DOD may be able to identify factors that lead it to believe that the proposed merger would lower the cost position of the merged firms and/or improve the design capability of the merged firms,

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[51] Merger Guidelines, at § 1.52. This provision is based on the Supreme Court's decision in United States v. General Dynamics Corp., 415 U.S. 485 (1974).

thereby creating the prospect that DOD would receive more attractive bids following the merger.

Case 2. Two of the four firms that DOD believes are capable of bidding on an upcoming procurement propose to merge. DOD views the two merging firms as the two leading competitors from both a cost and a technical standpoint. DOD also believes that, absent the merger, these firms would push each other to develop extremely attractive proposals in an effort to win the contract. DOD is concerned that the merger will remove this competitive pressure and result in a less aggressive bid. Finally, DOD does not see a significant long term cost or product quality benefit flowing from the proposed merger. Such input from DOD, supported by a detailed factual explanation supporting DOD's conclusions, would assist DOJ or the FTC in identifying a significant anticompetitive risk from the proposed merger.

4. Barriers to Entry

Under certain circumstances, the entry of a new firm may preclude an exercise of market power. A merger is unlikely to raise competitive concerns if entry into the relevant market "is so easy that market participants, after the merger, either collectively or unilaterally could not profitably maintain a price increase above premerger levels."[52] According to the Merger Guidelines, entry is easy if it "would be timely, likely and sufficient in its magnitude, character and scope to deter or counteract the competitive effects of concern."[53]

The Merger Guidelines generally consider entry to be "timely" only if it can occur within two years.[54] However, through the scheduling of its procurements, DOD may effectively extend or shorten the relevant entry time period.[55] For example, if a DOD competition is three years away, it may be appropriate to consider those firms that could enter within that period to compete effectively for the DOD award. Similarly, if a merger occurs a few months before a scheduled DOD competition, it may be appropriate to shorten the relevant time period for entry to reflect the difficulty of sufficient new entry occurring in a timely manner.

In evaluating the likelihood of new entry, the Merger Guidelines seek to determine whether it would be profitable for a firm to enter the market after the acquisition.[56] Entry will be "likely" in those instances where an entrant

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52 Merger Guidelines, at § 3.0.

53 Merger Guidelines, at § 3.0.

54 Merger Guidelines, § 3.2.

55 See William E. Kovacic, Merger Policy in a Declining Defense Industry, 36 Antitrust Bull. 543, 585-586 (Fall 1991).

56 Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104 at § 3.0.

would be able to capture enough sales, at premerger prices, to meet its minimum viable scale requirement.[57] Although the defense industry is generally characterized by high barriers to new entry,[58] and declining defense budgets act as a further disincentive to new entry, DOD may be able to facilitate new entry that might otherwise not exist, or DOD itself may be able to supply the relevant product.

In the past, DOD has occasionally funded the establishment of new suppliers in order to introduce the benefits of competition into previously sole-sourced programs. DOD often acquires ownership of the technology and the equipment produced during the design and production stage of a contract. The actual production of a particular item may be relatively easy if the blueprints and assembly steps are provided to a firm with the relevant build-to-print expertise. In addition, DOD may fund research and development efforts by several firms to preserve competition for future programs if costs are reasonable. During the 1980s, the size and value of many Cold War defense programs provided significant additional incentives for new entry. However, because of declining defense budgets, DOD may be far less willing, and in some cases simply unable, to spend funds to replace a supplier that is acquired by a competitor. Likewise, uncertain, and in many cases dramatically reduced, future DOD budgets may cause new entry to be far less profitable, and thus less likely to occur, than in the past.[59]

In addition to inducing new entry, DOD may be capable of producing a product itself in order to prevent anticompetitive effects of a merger. Indeed, in the past DOD occasionally entered into the supply of defense related products.[60] The fact that much DOD procurement activity in the future will consist of upgrading current systems may make government production a more

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[57] Minimum viable scale represents the smallest average annual level of sales that a new entrant must persistently achieve in order to be profitable at premerger prices. Merger Guidelines, at § 3.3.

[58] See, e.g., Jacques S. Gansler, Affording Defense, at 164 (MIT Press 1989) (a "unique characteristic of the defense industry worth emphasizing is that barriers to entry and exit are extremely high."); see also, William E. Kovacic, Merger Policy in a Declining Defense Industry, 36 Antitrust Bull. 543, 585 (Fall 1991) ("In evaluating the market power consequences of defense industry acquisitions, antitrust analysis generally should discount the possibility that adverse competitive effects of mergers between current weapons manufacturers will be offset by new entry into the defense industry.").

[59] The prospect that a new entrant will share in a reasonably expected decline in market demand reduces expected available sales opportunities. Merger Guidelines, at § 3.3.

[60] For example, the Alliant court noted that the Army had acted as a systems contractor for certain defense products, including the M910A5 ammunition round. Alliant, 808 F. Supp. at 15.

credible option. However, many of the barriers that may deter entry by private firms could also deter entry by DOD. Moreover, in the present environment, DOD may lack the funds to acquire the additional personnel and equipment necessary to enter many defense related markets.

If DOD believes it has the ability to defeat the exercise of market power by entry or encouragement of new entry, it will be essential to demonstrate to the agencies that it can and will act. For example, if DOD claims that it can produce the product if the postmerger firm tries to take advantage of its market position, it will be important for DOD to demonstrate that it has done so in the past, or that it clearly could do so (i.e., has the capacity and economic incentive) in a timely fashion in the future, and that the alternative could be pursued at acceptable cost and in the necessary time frame.

5. Competitive Effects

Generally, market concentration affects the likelihood that a single firm, or a small group of firms, can exercise market power. The Merger Guidelines recognize, however, that concentration data are "only the starting point for analyzing the competitive impact of a merger."[61] In evaluating the likely effects of a merger, the Merger Guidelines focus on two general theories of competitive harm: (1) the lessening of competition through coordinated interaction;[62] and (2) the lessening of competition through unilateral effects.[63]

a. Lessening of Competition Through Coordinated Interaction

The Merger Guidelines' coordinated interaction theory applies in those situations where a merger lessens competition by increasing the likelihood that the remaining firms in the market will be able to exercise market power collectively through either tacit or overt collusion.

One of the key factors that may lead to anticompetitive effects (i.e., higher prices) through coordinated interaction is a market structure in which relatively few firms account for a large proportion of sales. These firms may be able to exercise market power collectively by taking actions (such as raising prices or reducing output) that a single firm controlling a monopoly share of the market would take on its own to increase its profits. However, in order for a group of firms to exercise market power collectively, they need to be able both to reach agreement (either tacitly or expressly) on terms that are profitable for each firm and to detect and punish any deviations from the agreed-upon terms that would undermine the profitability of the coordinated terms for each participant. Merger Guidelines, § 2.1.

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61 Merger Guidelines, at § 2.0.

62 Merger Guidelines, at § 2.1.

63 Merger Guidelines, at § 2.2.

This theory of competitive effects -- lessening competition through coordinated interaction -- has formed the basis for the vast majority of the challenges to mergers that have been brought by the antitrust agencies in nondefense industries.

Market concentration is one of the factors necessary for harm to competition under the theory of coordinated interaction. Where there is a large number of sellers each accounting for a relatively small percentage of sales of the relevant product, there is little risk of successful coordinated interaction. As a result, mergers that do not result in concentrated markets do not present a threat to competition under the coordinated interaction theory. Concentration alone, however, is not sufficient for successful coordinated interaction. A number of other factors must be examined to determine whether it is likely that firms would reach and adhere to mutually beneficial agreements rather than defect from (and thus defeat) any coordinated action in order to increase their individual profits. Among the most important of those factors in the defense industry are (1) whether the firms' products are similar (homogeneous) or differentiated (heterogeneous); (2) whether there are few or many buyers of the product and the types of purchase arrangements typically employed by buyers; (3) whether purchases are frequent, regular, and small relative to the firm's output or, by contrast, are infrequent and large; and (4) whether the competing firms have similar costs and capabilities or vary significantly in their cost positions and technical sophistication. Merger Guidelines, §§ 2.11 & 2.12.

In many defense industry mergers, the risk of anticompetitive harm through coordinated interaction will be small even if the merger would eliminate one of a handful of competitors in a highly concentrated product market.[64] In the procurement of highly sophisticated weapons systems, a number of factors may make it difficult for firms to reach tacit agreements that would benefit each participant and may create strong incentives to defect from any collusive arrangement that might be made. First, the complex, heterogeneous nature of the products and the unique cost positions and technical capabilities of the competing firms generally can make it difficult for the firms to reach tacit agreements that would benefit all of the participants. Second, and perhaps more importantly, DOD often will be able to take steps that will serve to protect it against the risks of coordinated interaction. For example, DOD may elect to engage in large, multi-unit/multi-year procurements and employ a bidding mechanism to select a single (or primary) supplier.

A defense firm ordinarily will have a strong incentive to bid aggressively to win a given procurement because it will often involve all or a

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[64] As noted below, one of the merger scenarios that is likely to present a significant risk of anticompetitive effects is the proposed merger of the only two firms capable of producing or designing a particular product. Such a "2 to 1" transaction, by definition, will not raise coordinated interaction concerns because only one supplier would remain following the merger. Instead, such transactions will present unilateral effects issues.

large percentage of the market for the product for a multi-year period. Defense firms, unlike firms in other markets where there are multiple customers making small, repeated purchases, might find it difficult to employ a tacit arrangement that would involve rotating bids, allocating customers, or agreeing to make similar reductions in current levels of output, unless there is a way for the winning bidder to reward the losing bidder (e.g., through subcontract relationships).[65] With the rapid downsizing of the procurement budget, a defense firm frequently will confront a situation in which future procurements are uncertain and thus will be unlikely to engage in a tacit agreement that would require that it await the next procurement to benefit from the arrangement. The possibility that there will be no future procurement (or that it will be delayed for many years and that its value will be far less than the current opportunity), as well as the risk that its competitor may defect from such a tacit arrangement by bidding aggressively on any future procurements, may make successful coordinated interaction unlikely in certain defense industry procurements even where there are only a small number of firms capable of bidding.[66]

b. Lessening of Competition Through Unilateral Effects

The Merger Guidelines recognize that a "merger may diminish competition even if it does not lead to increased likelihood of successful coordinated interaction, because the merging firms may find it profitable to alter their behavior unilaterally following the acquisition by elevating price and suppressing output." § 2.2. Market share is a relevant factor under the unilateral effects theory. If the merging firms will have less than a 35% share of the relevant market after the merger, the Merger Guidelines assume that the firm will not be able to exercise market power unilaterally. § 2.211. Above this 35% threshold, such other factors as the closeness of the products of the merging firms to each other in their characteristics and customer appeal and the ability of other competitors to reposition their products to replace any loss of competition from the merger are relevant in assessing the risk of anticompetitive unilateral effects. Id. at §§ 2.211 & 2.232.[67]

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[65] The Justice Department recently secured a consent decree in a case where the only two competitors in the market teamed together to submit a joint bid. See, e.g., United States v. Alliant (C.D. Ill., Jan. 19, 1994). The companies formed the teaming agreement in a deliberate attempt to increase the price of the contract by avoiding competition. Under the consent decree, the companies have agreed to make payments totaling $12 million.

[66] In addition, the risk that new firms, or existing firms that were not part of the tacit agreement, would win any future procurement would also reduce the prospects for successful coordinated interaction in markets where contracts are awarded through a bidding process and bids are relatively infrequent.

[67] The Merger Guidelines also note that unilateral effects may result where the products are similar (homogeneous), the primary basis for distinguishing among

[Footnote continued on next page]

There are a number of situations in which defense industry mergers may present concerns under a unilateral effects analysis. The most obvious and most troubling cases are those in which the only two competitors in a product market propose to merge. In those cases, DOD may confront the prospect of a single supplier that will have the ability to exercise market power in future procurements. A second, related situation is presented where the two lowest cost competitors in a product market propose to merge. Where there is a significant gap between the cost positions of the two merging firms and the other competitors, DOD may be harmed by the loss of future head-to-head competition between the two current low-cost suppliers.

Competition in the defense industry generally has quality and technology components that may be as important or more important than competition on price. Quality-based competition is particularly important in the design phase of the procurement process. A merger that reduces the number of firms capable of developing a suitable design for a new weapons system may lead to higher prices, lower quality products, reduced advances in technology, and a reduction in the number, variety, or quality of the proposals submitted to DOD. All other things being equal, a merger is likely to present the greatest risks of these adverse competitive effects when the two most technologically capable firms propose to merge and there will be a significant quality/capability gap between the merged firm and its remaining rivals.

The defense industry has some unique characteristics that may mitigate concerns about unilateral competitive effects. DOD is often a monopsonist and can shift its purchases to other sellers or even enter the market itself. Moreover, DOD has unique access to regulatory and cost auditing procedures to control the conduct of defense contractors. As a result of its enormous budget, special statutory authority (e.g., ability to second source products, auditing, novation, change orders, etc.), long-term relationships with contractors, repeat purchasing, and status as a primary or sole customer, DOD has market power that far surpasses the typical buyer in a commercial market. While these factors may prevent DOD from facing some unnecessary costs, these regulatory controls do not guarantee a competitive price. DOD's experience, Congressional findings, the opinion of industry, and a large body of literature lead to the conclusion that DOD's regulatory and auditing procedures are not a substitute for competition in assuring the best mix of price and quality.[68] In fact,

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firms is their capacity, and other firms in the market face capacity constraints while the merging firms have excess capacity. § 2.22. This capacity-based unilateral effects scenario is unlikely to be relevant to the vast majority of defense industry mergers, in view of the heterogeneous nature of most defense products and the abundance of capacity to serve the rapidly shrinking demand.

[68] See, e.g., William E. Kovacic, Merger Policy in a Declining Defense Industry, 36 Antitrust Bull. 543, 584 (Fall 1991) ("The regulatory regime does

[Footnote continued on next page]

courts have enjoined several defense mergers, citing the likelihood of anticompetitive post-acquisition prices, despite the presence of DOD's regulatory safeguards.[69]

The effectiveness of DOD's controls may also be limited during the design and development stages of defense programs when competitive procurements are often awarded based on non-price considerations such as innovative design and technological advancement.[70] In the absence of competition, it is difficult, if not impossible, to estimate what type of advancements a competitive marketplace would have produced. For these reasons, DOD regulation cannot deliver the important non-price benefits of maintaining competition.

6. Claims of Efficiency

Sponsors of mergers and joint ventures will often argue that any anticompetitive effect will be outweighed by efficiencies, thereby saving DOD (and taxpayers) money, facilitating transfers of technology, promoting research and development, and contributing to national security. DOD can make a significant contribution in reviewing such claims and offering its opinion to the enforcement agencies.

Some mergers that may create or enhance market power "may be reasonably necessary to achieve significant net efficiencies."[71] "Net efficiencies" are defined as efficiencies net of the transaction costs associated with the acquisition and include, but are not limited to, "achieving economies of scale [in

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encourage some cost reduction by sole-source suppliers, but it often fails to generate the constant pressure to improve productivity experienced by firms confronted with strong alternative suppliers."); Jacques S. Gansler, Affording Defense at 186 (MIT Press 1989) ("[I]n the normal sole-source environment of defense production there is very little incentive for the producer to drive down his costs, and almost an incentive for him to raise his costs (since the subsequent year's production negotiations will be based on the preceding year's actual costs.)"); see also, Remarks of Dennis A. Yao, Commissioner, Federal Trade Commission, at Charles River Associates, Boston, Massachusetts, 1993.

69 See, e.g., Imo, 1992-2 Trade Cas ¶ 68,560 (merger between Imo and OEC will result in "such a controlling position in the market that there is a substantial likelihood that they could raise prices"); Alliant, 808 F. Supp. at 16 ("There is persuasive opinion in the record that Army oversight, while effective, is an imperfect substitute for the action of the competitive marketplace.").

70 The Merger Guidelines recognize that "sellers with market power also may lessen competition on dimensions other than price, such as product quality, service, or innovation." Merger Guidelines, at § 0.1, n.6.

71 Merger Guidelines, at § 4.

design as well as production], better integration of production facilities, plant specialization, [and] lower transportation costs" as well as "reductions in general selling, administrative, and overhead expenses."[72] But, in order to be considered, any such efficiencies must be greater than the likely anticompetitive effects, must be passed on to consumers, must be achievable only through the merger, and must be proven by those advocating the merger. In addition, the expected efficiencies "must be greater the more significant" the competitive risks associated with the merger.[73]

Certain kinds of long-term efficiencies particularly relevant to the defense industry are not specifically recognized in the Merger Guidelines. These include claims that a merger preserves and enhances long-term capabilities or allows the preservation in a single firm of exceptional and efficient design capacity. It is the view of the Task Force that these special efficiencies are simply variations on conventional claims, and, if adequately documented, can be presented and should be taken into account by the enforcement agencies. To the extent that these efficiencies relate to products other than the relevant product market involved in the merger, those efficiencies should be considered (if all savings will accrue to a single buyer), although they may be more difficult to substantiate.

Because the production of many defense-related products involves large fixed costs, the potential exists for merging defense contractors to achieve significant economies of scale, as well as other efficiencies. However, the claimed efficiencies are not relevant to the antitrust analysis "if equivalent or comparable savings can reasonably be achieved by the parties through other means."[74] Thus, alternatives to a merger such as joint ventures, subcontracting, directed procurements, teaming arrangements, potential mergers with other suppliers, and delaying the merger until upcoming bidding situations have been settled must be considered to determine whether similar efficiencies can be achieved in a manner that does not raise the same level of competitive concern.

The Supreme Court has declared that efficiencies are not relevant when a merger is examined in court. The most emphatic Supreme Court statement is in FTC v. Procter & Gamble Co.[75] in which the Court said, "Possible economies cannot be used as a defense to illegality. Congress was aware that some mergers which lessen competition may also result in economies, but it struck the balance in favor of protecting competition." Id. at 580. Most of the language about efficiencies being irrelevant is found in older cases. In recent

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72 Merger Guidelines, at § 4.

73 Merger Guidelines, at § 4.

74 Merger Guidelines, at § 4.

75 386 U.S. 568 (1967).

years, lower courts have examined efficiency questions in merger cases.[76] Efficiency claims as a mitigating factor are taken into account in certain types of joint venture cases, without any reference to any inconsistency with Supreme Court merger rules.

Nonetheless, efficiency claims will be examined by the enforcement agencies in the exercise of prosecutorial discretion. Valid efficiency claims are a mitigating factor in a merger. The government's general posture with respect to efficiency claims is skeptical.

There is some controversy about the extent to which reductions in overhead expenses and other fixed costs should be weighed against anticompetitive effects because it is somewhat less likely that reductions in overhead (as opposed to reductions in direct or variable costs) will be passed along to consumers in the short run. In the defense industry, however, the contracting process between DOD and defense firms clearly takes overhead factors into account. As a result, in the defense industry, claims of reduction of overhead should be treated as an "efficiency" and balanced against any anticompetitive effects as long as they are expected to be passed along to DOD. However, for the same reasons that DOD's cost auditing mechanisms are unable to ensure a competitive price, they may also be unable to ensure that reductions in overhead will be passed on to DOD.

DOD may be in a position to evaluate and explain claims of efficiency because of its experience as a long-term purchaser and its resultant knowledge base. DOD and the merging parties should recognize that claims of efficiency can and should be rejected if they do not flow directly from the merger, or if the same or comparable savings can be achieved by means less anticompetitive than a merger (for example, by a temporary teaming arrangement). Assuming DOD seeks to persuade the enforcement agencies that efficiency claims are valid and that the efficiencies would be substantial, it can play a more constructive role if it spells out the reasons for that conclusion. Two examples illustrate the point:

Case 1. In a five-firm product market, firms three and four seek to merge and defend the transaction, in part, by asserting that they both maintain expensive and complementary R&D facilities. The firms claim that the merger would reduce R&D costs by 20%, eliminate unnecessary duplication of effort, and result in better quality R&D.

Assuming DOD is persuaded that these claims are valid, it can play a constructive role in merger review by substantiating them. For example, it

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[76] For example, see FTC v. University Health Inc., 938 F.2d 1206, 1222 (11th Cir. 1991) (acknowledging that claims of efficiency are relevant but finding insufficient evidence in the record); United States v. United Tote Inc., 768 F. Supp. 1064, 1084-85 (D. Del. 1991) (efficiency claims not sufficient to overcome evidence of anticompetitive effects). No case has ever found an otherwise illegal merger saved because of efficiencies.

should be prepared to describe which overlapping R&D activities are unnecessarily duplicative, how and why the merger would lead to improved R&D, where savings are likely to come from and the magnitude of those savings. It also should be prepared to answer the question of why R&D joint ventures between firms three and four would not result in equivalent or greater savings. From the point of view of merger enforcement policy, a five-firm to four-firm merger could lead to anticompetitive effects and substantiated claims of efficiency may lead to a no action decision by the enforcement agencies.

Case 2. In a two-firm market, both firms may operate at less than efficient capacity, causing both to be unprofitable. If they seek to merge, they may argue in defense of the merger that it will allow the resulting firm to be profitable, and that in turn will assure a reliable source of supply and perhaps better quality products. An alternative to merger, however, is for DOD to set up a "winner-take-all" bidding contest. One firm will be awarded the contract, the other may go out of business (assuming it produces only one product), and the first firm can acquire those parts of the failed firms' equipment and personnel that will improve the quality of its operation.

A "winner-take-all" competition rather than a merger between two equally qualified firms -- with lower prices to DOD in the final round of contract bidding -- would almost always be to DOD's advantage. A merger to monopoly prior to the final contract round could be preferable if it could be demonstrated that the merger would lead more promptly to a single, efficient operation, either in the product that is of competitive concern or in other product lines, or that it would be practically impossible for the surviving firm to acquire essential assets or hire key staff personnel from the exiting firm in the open market -- and that the net result of the efficiencies is greater than the anticompetitive effect. Similarly, a proposed merger where one of the merging firms has multiple defense contracts, only one of which is involved in an imminent "winner-take-all" procurement, may involve more complex issues affecting other DOD interests. In short, a merger to monopoly without a final round of bidding is likely to have a highly anticompetitive effect, and can rarely be justified.

7. National Security Claims

All mergers in the defense industry may raise national security considerations in the sense that they may have some impact on the quality and price of products or services purchased by DOD. An increase in the price for any product or service means there is less money available to purchase other products, while a decrease in the quality of a particular weapon means that it will be less effective in battle. Used in this broad way, "national security considerations" could encompass all merger analysis.

The Task Force believes it is more appropriate to use the phrase "national security considerations" in a way that conveys the crucial and unique role of DOD in analyzing the needs of the nation in the event of a military conflict. In particular, we use the phrase "national security considerations" to refer to concerns that a particular resource, such as a manufacturing facility or a design team, is so crucial to the mission of the Defense Department that its

preservation is vital to the defense of the nation. For example, DOD might conclude that it is essential that a particular component of a vital weapon system continue to be produced, a particular research capability be maintained, or that capacity be maintained to expand production promptly in case of emergency. In such cases, the importance of preserving the resource may outweigh the policy concerns of merger analysis. Based on the history of actual mergers within the defense industry, however, the Task Force believes this kind of judgment will be appropriate in only a few cases.

Most claims that a merger or joint venture is important to national security are recognized by the antitrust agencies as "efficiencies" as that term is used in the Merger Guidelines -- i.e., the combined firms can produce a better product at a lower price, maintain long-term R&D capacity, or put together complementary resources or staff that will produce a superior product. There may be rare situations, however, where DOD may assert that a transaction is essential to national security, even though it may substantially increase concentration and not produce cost savings.

Strictly speaking, a "national security" argument in defense of an otherwise illegal merger is not an acceptable counterbalance to potential anticompetitive effects. See National Society of Professional Engineers v. United States, 435 U.S. 679 (1978). In practice, however, lower court judges have indicated a willingness to take national security considerations into account in reviewing mergers in the defense industry.[77] This occurs in part because many merger cases come to the court in the context of a request by the government for a preliminary injunction, and there is a "public interest" element to deciding whether an injunction should issue. If national security would be advanced by the merger, that will be regarded as a "public interest" reason not to issue an injunction. In addition, judges would likely give weight to a clear and substantiated claim by DOD that a merger is important to national security.[78] While courts will entertain the argument, no otherwise illegal defense industry merger reviewed by the courts has survived a preliminary injunction motion, or otherwise resulted in dismissal of a government charge, on a determination that public equities like national security outweighed anticompetitive effects.

As a practical matter, the best forum to assert national security arguments is before the enforcement agencies. The enforcement agencies will examine such arguments in the course of exercising prosecutorial discretion.

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[77] See, e.g., FTC v. Imo Industries Inc., 1992-2 Trade Cas. ¶ 69,943 (D.D.C. 1989); FTC v. Alliant Techsystems, Inc., 808 F. Supp. 9 (D.D.C. 1992).

[78] The district Court in Olin-Alliant indicated a willingness to take national security into account, but did not do so in that case because the official views of DOD were "conspicuously absent." 808 F. Supp. at 23 (D.D.C. 1992).

8. Failing Firm and Distressed Industry

Because of the dramatic decrease in defense industry purchases, many mergers and joint ventures will involve firms operating with significant excess capacity. The firms may argue that merger and joint venture restrictions should be eased in order to allow them to combine into a viable market competitor, and that unless a transaction is allowed to proceed, critical productive assets may exit the market.[79] This is another area where DOD's views are likely to be given weight and where it can play a constructive role in cooperating with the enforcement agencies in evaluating such claims.

a. Background: Case Law and Merger Guidelines

United States antitrust law has been rigorous in its definition of failing firm with the result that it is rare that an otherwise illegal merger or joint venture can survive because one of the parties would have failed anyway. The fact that an entire industry is in distress because of chronic excess capacity and inefficiency has been irrelevant in conventional merger enforcement. This position grows out of a preferred view that "survival of the fittest" is the best policy, and that excess capacity will eventually disappear as less efficient firms depart from the market.

The Task Force is not aware of a comparable situation in which an industry as large as the defense industry came into a condition of distress because of such an abrupt reduction in purchasing (except the defense industry after World War II). A somewhat more lenient definition of failing firm and distressed industry may apply as an exercise of prosecutorial discretion on the part of the antitrust agencies to mergers and joint ventures in the defense industry, particularly where the loss of defense production or research/development capacity might endanger national security.

Merger restrictions do not apply to "failing firms." But under the case law, a firm to be characterized as "failing" must be virtually on the steps of the bankruptcy court[80] and there must no other prospective purchaser available that poses a less severe danger to competition.[81]

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[79] In this context, the term "productive assets" includes, for example, skilled technicians, research/development capacity, and intellectual property.

[80] Technically the language describing the condition is that its "resources [are] so depleted and prospects for rehabilitation so remote . . . that it faced the grave probability of a business failure." United States v. General Dynamics Corp., 415 U.S. 485, 507 (1974) (quoting International Shoe Co. v. FTC, 280 U.S. 291, 302 (1930).

[81] Citizen Publishing Co. v. United States, 394 U.S. 131, 136-38 (1969).

The Merger Guidelines adopt similarly stringent language and provide that the defense is available only if the "failing firm" would not be able to reorganize successfully in bankruptcy.[82] Merger Guidelines, § 5.1. The Merger Guidelines also require that the failing firm prove that "it has made unsuccessful good-faith efforts to elicit reasonable alternative offers of acquisition of [its] assets" and that "absent the acquisition, the assets of the failing firm would exit the relevant market." § 5.1

In some instances, mergers in distressed industries can be defended on grounds they produce substantial efficiencies. But there is nothing in the Clayton Act case law or Merger Guidelines that would adjust antitrust enforcement -- absent efficiency claims -- when all or most firms in an industry are barely breaking even and are subject to long-term overcapacity.

The failing firm defense necessarily entails a balance between the likelihood that the merger will be beneficial because it is necessary to preserve the presence of the assets in the market, and the likelihood that the merger will be harmful because it is unnecessary to preserve the assets and increases market power. In conventional markets, the courts and the agencies have struck a balance by requiring for application of the failing firm defense an extremely high likelihood that the assets would leave the market absent the merger. However, where DOD concludes that it would be dangerous to national security if the assets exited the market, it might be appropriate to strike the balance differently. DOD can strengthen its argument by spelling out its views on the likelihood and consequences of business failure.

b. DOD Role

Where a firm alleges a conventional "failing firm defense," DOD can examine the claim and, from its special perspective, offer views to the enforcement agencies as to whether the firm is really on the brink of bankruptcy. DOD's exceptional base of profit and loss information gained through its auditing process and its knowledge of its own intentions about future orders gives it access to data not ordinarily available to firms in the private sector. On the other hand, DOD has no special expertise in assessing financial viability of failing firms and the enforcement agencies may have information, unavailable to DOD, bearing on the issue. Sharing information, to the extent permitted by law, as discussed below, seems the best approach.

More important, there are some arguments that DOD might offer concerning the special economic conditions in the defense industry that could influence the enforcement agencies or a trial court. Again, two examples illustrate the point:

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[82] A variation on the failing firm issue is a situation in which the firm, even though not strictly failing, may be so weak that its market share measured by percentage of past sales overstates its competitive significance. Enforcement agencies and courts will discount existing market shares in that situation. Merger Guidelines, at § 1.52.

Case 1. In conventional antitrust analysis, it is not enough that a firm will probably fail in the near future; failure must be imminent. The antitrust agencies may be receptive to DOD's suggestions that the definition of "failure" could be loosened by the enforcement agencies in exceptional circumstances when national security is a factor -- for example, where the capacity and special assets of the probably failing firm are important to production of an essential product and a prompt merger is necessary to preserve that capacity.

Case 2. While general "distressed industry" conditions are irrelevant in conventional antitrust, the antitrust agencies may be receptive to DOD's suggestion that economic instability and weak performance industry-wide threatens to eliminate needed surge capacity or lead to inadequate investment in long-term R&D (or lead firms to exit the industry) if DOD cannot easily preserve the firm's critical assets by contract or otherwise.

In both instances, simple assertions that a firm is "probably failing" or that an industry is "distressed" are unlikely to influence prosecutorial decisions. Claims of failure, economic instability, and consequent effect on national security will have to be validated with substantial support.

DOD also may have relevant views as to whether an alternative purchaser who may present a lower risk of anticompetitive consequences has the skills and knowledge necessary to operate the assets in a way that will ensure that they remain available for national defense purposes.

C. Antitrust Enforcement Agency Review Procedures

1. Informal Review Process

When requested, FTC or DOJ staff will provide companies with an informal opinion about the possible antitrust concerns associated with a potential transaction. Such an opinion may be sought for a wide range of transactions including mergers, teaming arrangements and joint ventures. Although non-binding, those closely involved in the merger review process state that to the best of their knowledge no informal staff advice has ever been overruled at a higher level.

2. Clearance

Because both the FTC and DOJ have concurrent jurisdiction over mergers, the two agencies use a clearance procedure to determine which agency will review a particular transaction. After an agency learns about a transaction, it may not believe there are any competitive problems and therefore may grant early termination of the statutory waiting period. The agency may also request clearance, which, when granted by the other agency, authorizes the agency to review the transaction and to contact outside parties for information relevant to the acquisition at issue. Until the FTC or the DOJ receives clearance, neither agency is permitted to contact the companies involved or third parties.

In the past, in rare cases, the antitrust agencies have been unable to settle which agency is to review a particular transaction until late in the waiting period. This may have led to requests for additional information that would have been narrowed had clearance been granted earlier. In order to expedite the selection process and avoid requests for additional information that may be unnecessary if the agencies have sufficient time to determine that there are no competitive problems with a particular transaction, the FTC and DOJ have recently issued new clearance guidelines.[83]

With regard to Hart-Scott-Rodino filings, both agencies must "seek to resolve claims within 10 calendar days after receipt of the filings."[84] If the claims are not settled within 10 calendar days, then both agencies will follow alternative procedures to resolve the issues.[85]

3. The Hart-Scott-Rodino Process

Pursuant to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, prior notification must be made to the FTC and the Department of Justice before parties can consummate mergers or acquisitions above a certain size. The relevant companies must submit a premerger filing, which includes general information about the merging companies, their lines of business, and the proposed transaction. Once the necessary filings have been submitted to the federal government, either the FTC or the Department of Justice receives "clearance" to review the proposed transaction for possible antitrust concerns.

The Hart-Scott-Rodino Act sets forth time limits for the governmental review of mergers and acquisitions reported under the statute. Once the required filings have been submitted, the companies must wait 30 days before they are permitted to merge.[86]

If the reviewing agency determines that no antitrust problems exist, then the merger or acquisition may be consummated at the end of the waiting

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[83] Clearance Procedures for Investigations," Antitrust Division of the United States Department of Justice and the Bureau of Competition of the Federal Trade Commission, issued December 2, 1993 (hereinafter "Clearance Procedures").

[84] Clearance Procedures, at 1. With regard to cash tender offers specifically, the agencies will endeavor to resolve claims within five calendar days.

[85] A determination as to which agency will receive clearance is based primarily on which has greater expertise in the particular product(s) involved in the merger.

[86] If the proposed transaction involves the acquisition of assets that are under the control of a bankruptcy court, the statutory waiting period will be 10 days. In the case of a cash tender offer, the statutory waiting period is 15 days. Where it is clear that there are no competitive concerns, the antitrust agencies can terminate the waiting period prior to the statutory time period.

period. On the other hand, if the proposed acquisition raises antitrust concerns, then the reviewing agencies may require the companies to provide further information. In order to gather such information, the reviewing agency may issue a request for additional information ("second request") to both companies prior to the expiration of the Hart-Scott-Rodino waiting period. The issuance of a second request essentially tolls the running of the statutory waiting period.

Once the companies certify that they are in substantial compliance with the second request and the reviewing agency approves the certification, the reviewing agency has 20 days to bring an action to enjoin the proposed transaction in federal court. In the case of a cash tender offer, the reviewing agency has 10 days from substantial compliance to bring action. If no action is taken within the allotted time period, then the acquisition may be consummated.

Because requests for information are, by necessity, far ranging, the response to such requests often totals hundreds of thousand pages of information that deal with the very issues the antitrust authorities must analyze. Such richness of information (along with interviews and documents from competitors, customers, suppliers, other governmental agencies, trade associations, consumer groups, consulting groups, industry experts as well as the parties themselves) gives the agencies great insight into the antitrust aspects of a particular transaction.

VI. PROCEDURAL REFORMS

This part of the report addresses a number of important procedural considerations, including (1) the responsibilities of DOD and the antitrust agencies in merger analysis; (2) the staff and resources DOD will need to coordinate its review of mergers within the defense industry; and (3) the sharing of information between DOD and the antitrust agencies.

A. Coordinating the Roles of DOD and the Antitrust Agencies

The appropriate responsibilities of DOD and the antitrust agencies in merger analysis follow from their statutory authority as well as their capabilities and expertise. The following section sets out what the Task Force believes those responsibilities should be.

1. The Department of Defense

As discussed in earlier sections, DOD has paramount responsibility for protecting national security. As the sole purchaser of most large-scale weapons systems furnished by American defense companies, DOD is a good source for information about the defense industry. In addition to its knowledge about products and suppliers, DOD has the responsibility and authority to establish procurement policy. Consistent with statutory requirements, it decides what to buy and when to buy it. DOD must determine the quantity and type of products and services to be acquired, the quality and characteristics that they must offer, and the degree to which any product or service is essential to national

security. Thus, DOD is particularly qualified to assemble facts and offer views that are important in assessing the competitive consequences of a merger.

2. The Antitrust Agencies

The antitrust agencies have considerable experience and expertise in evaluating the competitive effects of commercial transactions, including defense mergers. Both DOJ and FTC staff regularly appear in court and provide legal and economic analysis in complex and extensive merger litigation. DOJ and FTC staff have the statutory responsibility for setting out the government's views about the meaning and application of the antitrust laws to the judicial branch.

The expertise of the antitrust agencies extends to all industries. It includes the ability to analyze the dynamics of particular markets and the likely effects of a merger on product price and quality as well as other elements of market performance. In addition, both antitrust agencies have assembled teams of lawyers and economists with specialized experience in the competitive analysis of mergers within the defense industry, many of whom have access to classified information. Indeed, the antitrust agencies have reviewed hundreds of mergers within the defense industry over the last 15 years, a large number of which have been subject to in-depth evaluations.

3. Avoiding Duplication of Effort

DOD and the enforcement agencies should cooperate in the review process in a manner that avoids unnecessary duplication of effort. Congress has imposed limited waiting periods on parties to proposed mergers under the Hart-Scott-Rodino Antitrust Improvements Act in order to allow the antitrust agencies to complete an investigation prior to consummation. These waiting periods are statutorily limited, however, to encourage the antitrust agencies to expedite their investigations and enforcement decisions. It is, therefore, important for DOD to develop the capability to act promptly in assembling information to assist the antitrust agencies in evaluation of defense industry mergers within the time frame of the Act and to provide its comments and analyses in a timely fashion.

4. The Responsibilities of DOD and the Antitrust Agencies

The expertise of DOD and the antitrust agencies, the statutory authority delegated to them, and the need to avoid duplication of effort suggest a constructive cooperation in the analysis of mergers. As a matter of law, as well as expertise and experience, the antitrust agencies bear responsibility for determining the likely effects of a defense industry merger on the performance and dynamics of a particular market and whether a proposed merger should be challenged on the grounds that it may violate the antitrust laws. In making those determinations, the antitrust agencies assemble a significant body of data and information. For a variety of reasons, DOD has decided that it will play a more active role in the government's evaluation and review of the restructuring of the defense industry, including antitrust review by the agencies.

The Task Force has concluded that DOD has information on several issues important to the analysis by the antitrust agencies of the competitive merger of defense contractors, including: the characteristics of the products or services to be acquired by DOD; identification of the suppliers that appear reasonably capable of providing such products or services and the difficulties that particular companies would encounter in attempting to supply them; the time required for particular suppliers to achieve various stages in the procurement and production process; and any benefits to the production, design, research or other capabilities of the merging parties likely to result from a merger, including the possibility of lowering costs of production, increasing product quality, and facilitating research and development. DOD may also have expertise or information about other factors relevant to the competitive analysis of a proposed merger. For example, DOD may have a unique ability to identify a resource controlled or produced by a party that is essential to national security. Finally, DOD may have additional concerns about a proposed merger, such as other national security considerations or the effect of a merger on the defense industrial base, that it may want to communicate to the antitrust agencies and, if necessary, to the courts.

The Task Force concluded that the antitrust agencies should continue to determine the ultimate question of whether a merger of defense contractors should be challenged on the ground that it violates the antitrust laws, or what is an essentially equivalent question, the overall competitive consequences of a merger. The Task Force also concluded that, when appropriate, DOD should communicate its views concerning a proposed merger to the antitrust agencies. DOD should provide any facts, analyses, or information relevant to the agencies' analysis of the likely competitive consequences of a proposed merger, as well as any other views or information it considers significant. DOD's views and analyses will be particularly significant in those areas where DOD has special knowledge and expertise.

DOD's views, analyses, and factual information should be carefully considered by the antitrust agencies. In making an overall competitive assessment, the weight the antitrust agencies may attach to any DOD view or analysis will likely be influenced by the degree to which it is documented, based on specific factual information and quantified to the extent possible. Where appropriate, the antitrust agencies should give DOD's assessment substantial weight in areas where DOD has special expertise and information, such as national security issues.

Our view is that, if DOD is to take a more active role, it is important for DOD to have the institutional capacity to assemble and transmit information and views in the case of certain significant mergers. It is not necessary for DOD to do so in every case. In some cases, DOD may initiate no action or may simply respond to questions posed by the antitrust agencies rather than prepare an independent analysis.

B. Developing Expertise Within DOD

The Task Force concluded that DOD should have an internal capacity to analyze antitrust law issues, economic and financial issues, and technical issues. However, it is undesirable for DOD to develop the independent capability to perform a comprehensive competitive analysis of a proposed merger. The staffing necessary for such a capability would largely duplicate the staff in the antitrust agencies and, therefore, would be both unnecessary and wasteful.

Instead, we recommend a much more limited assignment of staff within DOD to merger issues. In particular, we recommend that DOD assign an experienced antitrust lawyer (perhaps with the assistance of a junior lawyer) within the Office of the General Counsel to have responsibility for coordinating these activities, including performing the following functions: (1) serving as point of contact within DOD for inquiries from members of the defense industry regarding proposed mergers; (2) coordinating consultations between DOD and the antitrust agencies about a particular transaction; (3) compiling information and soliciting views within DOD on the transaction; (4) coordinating and overseeing DOD's efforts to furnish information to the antitrust agencies and to prepare any analysis for use by the antitrust agencies; (5) coordinating and overseeing the use of documents or testimony of witnesses in merger litigation;[87] and (6) advising responsible DOD officials on the transaction.

By taking this approach of limited staffing, we anticipate that the added cost to DOD will be modest. Even this limited assignment of staff should be viewed as temporary and subject to review and reconsideration within a limited period of time.

We recognize the frequent practice of informal discussions between members of the defense industry and various DOD officials about possible mergers. We do not intend by this recommendation to foreclose these communications or to formalize them unduly. Rather, our recommendation is that there should be an individual designated to keep track of these inquiries and that officials within DOD who are contacted regarding a possible merger should notify this designated individual. In addition, this individual would coordinate the gathering and evaluation of information in the event that DOD concludes that a transaction warrants analysis. Thus, this person would regularly consult with the antitrust agencies about the possibility of a particular transaction whenever DOD concluded that a merger was sufficiently likely and significant and it elects to initiate such an assessment.

C. Sharing Information

DOD and the antitrust agencies should develop procedures for consultation and sharing of information in order to facilitate the assessment of

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87 Official testimony by DOD employees is governed by 32 C.F.R. §§ 97.5-97.6 (1992).

potential mergers. Such consultations would take place early in the process of DOD's analysis of a transaction.

The Task Force recognizes the desirability of avoiding a protracted analysis of any proposed merger prior to an enforcement decision. The time consumed by investigation and analysis of complex mergers may complicate legitimate business planning, create a cloud of uncertainty over a particular transaction, and, in extreme cases, make it impossible for the parties to proceed even if a transaction offers considerable benefits. Indeed, these concerns extend beyond the defense industry to all areas of the economy. On the other hand, mergers raise a host of complex questions involving their effect on competition as well as other important public policy values. Moreover, the antitrust agencies are constrained in the time available for review by statutory limits, and the length of an investigation is often greatly influenced by the time taken by the parties to respond to the agencies' request for information. Finally, in the defense industry, traditional merger analysis may be even further complicated by the special nature of DOD procurement policies, national security considerations, and other matters. Thus, it is not realistic to expect that all merger analysis can be -- or should be -- completed in a very short period of time.

The Task Force believes that the process of merger analysis can be expedited in many cases by early consultations by the parties with the antitrust agencies. Parties to a potential merger already have the opportunity to seek advice from the agencies or to consult informally with agency staff about the potential competitive consequences of a possible merger. Although such advice does not legally bind the agencies, it has never so far been the case that either agency challenged a merger if the agency or its staff has advised that a transaction is unlikely to violate the antitrust laws. The Task Force concluded that this informal advisory process can be useful to companies considering a merger and recommends that the antitrust agencies reiterate its availability to companies within the defense industry.

Parties to a potential merger often engage in discussions with DOD officials prior to making a final decision regarding whether to proceed with a transaction. These consultations can be extremely informal with little or no discussion or evaluation of competitive consequences and under circumstances where the likelihood of the parties actually proceeding with a merger is unknown. Also, the parties may have legitimate reasons for keeping such consultations confidential, particularly where the companies involved have not decided whether to proceed with a transaction. In such cases, DOD is unlikely to initiate any extensive evaluation of the transaction and there is no particular benefit in notifying the antitrust agencies.

On the other hand, if DOD considers a potential merger likely and significant, the Task Force recommends that DOD notify the antitrust agencies of the possibility of a particular transaction and that it cooperate fully with the antitrust agencies to facilitate their antitrust review. This early consultation not only assists the antitrust agencies in initiating their own competitive evaluation of a transaction, but can assist the DOD in identifying and analyzing relevant

information. Such consultations should, if possible, be initiated prior to a formal premerger notification to the antitrust agencies.

It is uncertain whether the antitrust agencies are permitted to share with DOD documents submitted pursuant to a premerger notification or second request because of the provisions of the Hart-Scott-Rodino Antitrust Improvements Act. Therefore, if DOD is asked by the parties to go beyond informal advice with respect to the proposed transaction, it should condition its participation on a commitment by the parties to release to DOD any documents submitted to the enforcement agencies that DOD wants to receive or the enforcement agencies believe DOD should review.

In the course of consultations with the enforcement agencies, the DOD should, if it believes it is appropriate, provide any information at its disposal that bears on the competitive consequences of a particular transaction, including: (1) documents generated by the DOD, the parties, or others; (2) DOD's own existing studies or case histories; and (3) the opinions and assessments of DOD officials and employees. The antitrust agencies should also cooperate with DOD to assist DOD in identifying and evaluating relevant information.

Information provided to DOD for this purpose may include sensitive and proprietary information that the parties to a proposed transaction will want to protect from release to any other parties. DOD should agree to protect the confidentiality of this information to the extent permitted by law and consistent with its statutory responsibilities.

Parties submitting this information should recognize that a number of constraints prevent DOD from guaranteeing absolute confidentiality. The Freedom of Information Act (FOIA), 5 U.S.C. § 552, is one such constraint. Sensitive financial or commercial information that would be necessary for DOD's analysis usually would be exempt from the FOIA's disclosure requirements under exemption 4, which protects "trade secrets and commercial or financial information [that is] privileged or confidential." 5 U.S.C. § 552(b)(4). It is DOD's practice to claim this exemption, where appropriate. Under the governing case law, courts are likely to uphold DOD. DOD's assertion of the exemption cannot guarantee protection of this information, however. Either a court order compelling release of the information or notice from the Department of Justice that it would not defend the claimed exemption in a FOIA lawsuit would defeat DOD's exemption 4 claim.

Companies providing information to DOD should also understand that it is customary for DOD to cooperate with requests for information from chairs of congressional committees acting on committee business. DOD has in the past advised companies that in the event of a request from Congress, DOD would give the companies advance notice of any disclosure and advise the committee of the confidential nature of the information. Finally, companies should be aware that DOD may be required by other federal government agencies, such as the General Accounting Office, to provide information. DOD has in the past agreed to notify the companies involved of such a request in advance of any disclosure. These

assurances from DOD, while not guaranteeing confidentiality, should alleviate companies' concerns about unwarranted disclosure of proprietary information.

In summary, involvement of DOD at an early stage in the analysis of a merger will usually expedite, rather than delay, merger enforcement decision. Because of the potential for DOD to play a valuable role, the antitrust agencies will be able to expedite their own investigations. Most proposed mergers in all sectors of the economy do not present antitrust concerns. Thus, in most cases, once the essential characteristics of the merger are understood, the antitrust agencies can communicate a decision not to bring an enforcement action. DOD can play a constructive role in bringing these merger investigations to an early conclusion.

APPENDIX A

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THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

ACQUISITION

12 OCT 1993

MEMORANDUM FOR CHAIRMAN, DEFENSE SCIENCE BOARD

SUBJECT: Terms of Reference -- Defense Science Board Task Force on Antitrust Aspects of Defense Industry Consolidation

As the defense industrial base is downsized and consolidation occurs in the defense industry, antitrust issues inevitably will arise. The Department of Defense has a responsibility to comment on cases that come before the Department of Justice and the Federal Trade Commission on the consequences for the national defense of approving or disapproving a proposed merger or joint venture. How the Department should go about discharging its responsibility is not clear. This is an important issue for the Department and an appropriate subject for the Defense Science Board because of the defense industrial base implications of how antitrust considerations are applied to mergers flowing from consolidation in the defense industry.

You are requested to form a Defense Science Board Task Force for the purpose of providing advice concerning (1) appropriate criteria for determining the Department's views on a given transaction, (2) the data required to do so, (3) the analytical capabilities required to do so, and (4) appropriate means for communicating with the enforcement agencies. Our objective in establishing the Task Force is not to generate antitrust guidelines for the defense industry or to promulgate antitrust policy for the enforcement agencies, but to obtain advice for the Department to use in formulating and expressing its views on proposed mergers. The Task Force is to have no role in assessing particular mergers.

The Task Force study will be co-sponsored by the Under Secretary of Defense (Acquisition) and the General Counsel. Robert Pitofsky will serve as the Chairman of the Task Force. Stephen W. Preston will serve as the Executive Secretary, and John V. Ello will serve as the Defense Science Board Secretariat Representative. The Under Secretary of Defense (Acquisition) will provide funding and other support as may be necessary. The Task Force should begin its work as soon as possible and provide an interim report in January 1994, with a final report due on or about May 1, 1994.

John M. Deutch

APPENDIX B

APPENDIX B

Membership and Staff

The Task Force members were selected by the Under Secretary of Defense (Acquisition and Technology) and the General Counsel, in consultation with the Chairman of the Task Force, Robert Pitofsky. Mr. Pitofsky is a Professor of Law and former Dean of Georgetown University, with a specialty in antitrust law. He is also an attorney serving as Counsel with Arnold & Porter. Mr. Pitofsky served from 1978 to 1981 as Commissioner of the Federal Trade Commission (FTC) and from 1970 to 1973 as Director of the FTC's Bureau of Consumer Protection. He served as chair of the Clinton Administration Transition Team reporting on the Antitrust Division of the Department of Justice.

Edward Correia is a Professor at the Northeastern School of Law. Mr. Correia served as Chief Counsel and Staff Director to the Senate Subcommittee on Antitrust from 1987 to 1989 and as Chief Legal Advisor and Staff Director to Federal Trade Commissioner Michael Pertschuk from 1981 to 1984.

Charles Fowler is a private consultant specializing in defense and engineering issues. Mr. Fowler has held senior positions in a number of defense firms and in the Defense Department. He is a member of the Defense Science Board.

Cornish F. Hitchcock is an attorney with Public Citizen Litigation Group.

Robert Litan is the Deputy Assistant Attorney General of the Antitrust Division of the Department of Justice. A former partner with Powell, Goldstein, Frazer & Murphy and a former Senior Fellow at the Brookings Institution, Mr. Litan has represented both plaintiffs and defendants on antitrust matters and provided expert antitrust consulting services, including advising the Senate Judiciary Committee on antitrust policy.

Janet McDavid is a partner at Hogan & Hartson, where she has developed a significant practice representing defense industry firms in antitrust investigations. Ms. McDavid has also published a number of articles on antitrust issues. She served on the Clinton Administration Federal Trade Commission Transition Team in 1992 and is a member of the Council of the American Bar Association Section on Antitrust Law.

Steven Newborn is a partner and head of the Washington antitrust practice at Rogers & Wells. Until March 1994, he was Director of Litigation of the Federal Trade Commission's Bureau of Competition. He has been counsel for the government in numerous trials including every successful antitrust challenge in the defense industry. He has served as special Assistant United States Attorney, is a member of the faculty of the National Institute of Trial Advocacy, and the vice chairman of the American Bar Association's Clayton Act Committee. He was a major contributor in both the drafting and the enactment of

the 1992 Federal Merger Guidelines. He lectures on antitrust and litigation to law schools, government agencies, industry groups and law firms throughout the United States and Europe.

Bernard Schwartz is Chairman and Chief Executive Officer of Loral Corporation, one of the country's largest defense contractors.

Carl Shapiro is a Professor of Business and Economics at the Haas School of Business and the Department of Economics, University of California at Berkeley, where he leads the program on Business Strategy. He is editor of the Journal of Economic Perspectives and a Principal of the Law & Economics Consulting Group. Professor Shapiro has been an Alfred P. Sloan Fellow and a Fellow at the Center for Advanced Study in the Behavioral Sciences, as well as the principal investigator on numerous National Science Foundation grants. He has published and consulted in the areas of antitrust and regulatory economics, industrial organization, intellectual property, and competitive strategy.

Ronald Stern is Senior Counsel for Antitrust Law and Competition Policy at General Electric Company. Mr. Stern was formerly a partner with Arnold & Porter and served as Special Assistant to the Assistant Attorney General for the Criminal Division of the DOJ from 1978 to 1980.

Robert Willig is Professor of Economics and Public Affairs at Princeton University. He is a director of Consultants in Industry Economics Inc. Mr. Willig was Deputy Assistant Attorney General of the Antitrust Division of the Department of Justice from 1989 to 1991.

Stephen Preston, Principal Deputy General Counsel of the Department of Defense, serves as the Executive Secretary of the Task Force. John Ello is the Defense Science Board Secretariat Representative. Amy Jeffress, Special Counsel, Office of the General Counsel, and Captain Ronald Phillips, Judge Advocate General's Corps, U.S. Army, serve as the Task Force staff attorneys.

APPENDIX C

APPENDIX C

Proceedings

The Task Force met seven times between October 18, 1993 and February 15, 1994. At these meetings, the Task Force heard briefings by senior Defense Department officials on the defense industrial base and on the defense procurement process as well as presentations from two defense industry executives, an economics professor with knowledge of defense industry issues, and a commissioner of the FTC.

Approximately 30 interested and knowledgeable parties were invited to submit their views on the Task Force's project. The following parties submitted written comments:

Danielle Brian, Director, Project on Government Oversight

Stephen K. Conver, Vice President for Technical Operations, Martin Marietta Electronics Group

Don Fuqua, Aerospace Industries Association

Donald A. Hicks, Chairman, Hicks & Associates

Craig S. King, Arent, Fox, Kintner, Plotkin & Kahn

William P. Rogerson, Professor of Economics, Northwestern University

Edward J. Shapiro and Jonathan S. Miller, Latham & Watkins

Lawrence F. Skibbie, American Defense Preparedness Association; Dan C. Heinemeier, Electronic Industries Association; James R. Hogg, National Security Industrial Association; and Don Fuqua, Aerospace Industries Association

William H. Taft, Fried, Frank, Harris, Shriver & Jacobson

Donald E. Willis, Vice President, Alliant Techsystems

Richard Feinstein, McKenna & Cuneo

William E. Kovacic, Professor of Law, George Mason University School of Law

Patrick M. Sheller: Paper Prepared Under the Auspices of the Defense Industrial Base Committee of the ABA's Section of Public Contract Law

The first draft of the Report was compiled from sections drafted separately by groups of Task Force members. The Task Force met in January, 1994, to work through this first draft. The Report was then revised in accordance with the discussion and a second draft circulated in February. The Task Force met again in February to discuss and complete a final draft which was circulated to all Task Force members for approval.